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German Tax and Legal News

Lower tax court rules on conditions for participation exemption for dividends

Tax court provides clarification on the application of the 10% minimum shareholding requirement for the participation exemption.

In a decision dated 13 October 2020 and published on 21 April 2022, Germany's lower tax court of Saxony ruled that separate share acquisitions in a given year should not be considered separately when determining whether the required 10% minimum shareholding is met for purposes of the participation exemption for dividends.

Background

Under the current participation exemption rules, dividends are effectively 95% tax exempt, provided a minimum shareholding of at least 10% exists at the beginning of the calendar year. Based on the applicable rules (section 8b (4) sentence 6 CITC), the acquisition of a shareholding of at least 10% that takes place during the calendar year is deemed to have taken place at the beginning of the calendar year. As a result, it should be possible to meet the requirements of the participation exemption for dividends related to such a shareholding even if the acquisition takes place during the calendar year.

In this respect, it has been unclear if a shareholder that already owns, or is deemed to already own, a minimum shareholding of 10% at the beginning of the calendar year and acquires additional shares during the calendar year qualifies for the application of the participation exemption for dividends related to the additional shares if the acquired additional shares amount to less than 10% in the company.

Lower tax court case

In a case decided by the lower tax court of Saxony, shareholdings in a German GmbH were acquired by a sole acquirer from existing shareholders on 25 February 2015 in the following amounts:

- From shareholder A: 3.27% (notarial deed 1) and 25% (notarial deed 2)
- From shareholder B: 3.27% (notarial deed 1) and 25% (notarial deed 2)
- From shareholder C: 3.46% (notarial deed 1) and 25% (notarial deed 2)

The remaining 15% of the shares in the GmbH were held by third parties.

On 25 March 2015, the GmbH made a dividend distribution to its shareholders. The tax authorities determined that the dividend with regard to the acquired 75% of shares (i.e., 3 x 25%) qualified for the participation exemption based on the provisions of section 8b (4) sentence 6 CITC. For the remaining 10% of acquired shares (i.e., 2 x 3.27% and 1 x 3.46%), the tax authorities did not apply the participation exemption because the share acquisitions, in their opinion, must be viewed separately to determine whether the 10% threshold had been reached. As the 3.27% and 3.46% share transfers were separate legal transactions and viewed separately from the other 2015 transactions, the tax authorities treated the dividends paid on the remaining 10% of the acquired shares as taxable dividends not qualifying for the participation exemption.

The lower tax court, however, did not follow the view of the tax authorities and rejected the arguments in line with the prevailing view under the tax literature. The lower tax court ruled that the acquisition of the 75% shareholdings led to the result that the deemed shareholding at the beginning of the calendar year exceeded the 10% threshold and, based on the wording of the law, the shareholder met the requirements for the participation exemption for the total amount of its shareholding. Therefore, the acquisition of the three shareholdings of less than 10% each were not viewed separately but, rather, were combined with the remaining shareholding percentages that were acquired in determining whether the threshold was met.

Currently, the case is pending at the federal tax court.

Comments
The ruling of the lower tax court provides welcome clarity on the question as to how the required 10% minimum shareholding that is acquired during a calendar year must be determined for purposes of the participation exemption rules. Affected taxpayers that have been subject to dividend taxation because the participation exemption rules were denied in a comparable situation should carefully reconsider the facts of their case and consider filing an objection against the relevant assessments.

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