



## Tax News

## Germany

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### **Withholding tax refund opportunities for foreign investors with dividends from portfolio investments in German corporations and new domestic taxation of portfolio investments**

#### **At a glance**

German withholding tax law violates European law pursuant to a decision of the European Court of Justice (ECJ) dated October 20<sup>th</sup>, 2011 (C-284/09). Today both chambers of German parliament decided on a new act (EuGHDivUmsG). The new law is already applicable as of today, March 1<sup>st</sup> 2013. It changes the tax rules for domestic (German) investors receiving dividends from portfolio investments and clarifies open questions regarding withholding tax refunds to foreign investors.

#### **Background**

Dividends distributed by corporations resident in Germany (German legal forms SE, AG, KGaA, GmbH, UG, foreign corporations with place of management in Germany) are subject to German withholding taxes (in general 26.375%). If the EU-Parent-Subsidiary Directive is applicable to foreign corporate shareholders, the withholding taxes could be avoided by a tax exemption certificate in advance or could be refunded by the German Central Tax Office. If the requirements are not met, especially the minimum shareholding of at least 10%, withholding taxes will be triggered without any possibility to apply for a refund. Therefore non-German corporate shareholders receiving dividends from portfolio investments in German corporations (shareholding of less than 10% in the corporation) are debited with German withholding taxes. In contrast to this, corporations resident in Germany (domestic corporate shareholders) can credit their German withholding taxes paid against their German Corporate Income Tax liability. Since the German Corporate Income Tax Act provides that dividends received by domestic corporate shareholders from other corporations are tax free irrespective of any minimum shareholding requirements, domestic corporate shareholders get a refund of the German withholding taxes paid. ECJ decided that this violates the European freedom of movement of capital as domestic corporate shareholders are treated in a more favorable way than foreign corporate shareholders.

#### **Solution by amendment of the law**

Therefore, law has changed today. Now dividends from portfolio investments are fully taxable for domestic corporate shareholders. The government has to avoid that German law violates European law. However, for many reasons it is still questionable whether a reliable solution has been found. Among others it is a problem that the new law provides that the (very complex) German domestic anti-treaty-shopping rules have to be considered. It is questionable whether these rules do not violate European law as an obstacle itself since these rules are not applicable to domestic corporate shareholders. Furthermore it is doubtful whether the exclusion of corporate shareholders resident not in a European Union and not in a European Economic Area (Iceland, Liechtenstein and Norway) member state from the opportunity to apply for a refund of withholding taxes does not violate the European freedom of movement of capital because this freedom rule is not limited to intra-EU/EEA investments.

#### **What is the effect of the new law?**

If foreign corporate shareholders did not interpose a German corporation for their portfolio investments in German corporations (which is quite rare), the amendment of the law regarding the taxation of dividends from portfolio investments may not be relevant for them. However, for foreign corporate shareholders holding directly portfolio investments in corporations resident in Germany, the new law provides rules for a refund of withholding taxes for dividends being distributed until February 28<sup>th</sup>, 2013.

#### **Who can apply for a refund?**

In general foreign corporate shareholders resident in EU- or EEA-member states are eligible to apply for a refund of German withholding taxes on dividends distributed from German corporations until February 28<sup>th</sup> 2013, if the corporate investor holds directly less than 10 percent of the shares in German corporations and if some further requirements are met. For foreign corporate shareholders having received dividends from portfolio investments and being not resident in a EU- or EEA member state a refund is not possible pursuant to the wording of the new law. However, we see chances that they can also apply for a refund. Individuals or partnerships are not eligible for any refund.

#### **What should be done now?**

After the ECJ decision in 2011 it had already been recommended to apply for a tax refund. However, the applications were not processed by the German tax authorities. In addition it was not clear which German tax office was responsible for the refund. Now the law provides that the German Central Tax Office is solely responsible. Therefore any foreign shareholder with the legal form of a corporation having received dividends from portfolio investments in German corporations (at least starting January 1<sup>st</sup>, 2009 until February 28<sup>th</sup>, 2013) should check now whether an application for a refund of the German withholding taxes paid may be recommendable. We are pleased to assist you on request.

Munich, March 1<sup>st</sup>, 2013

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