EU TAX ALERT 3/2018

AG Wathelet issued his opinion on the compatibility with the free movement of capital of German rules on the taxation of dividends from third countries

On 7 February 2018, AG Wathelet of the Court of Justice of the European Union ("CJEU" or "Court") issued his opinion in the case of EV v. Finanzamt Lippstadt (Case C-685/16).

The case concerns the tax treatment of dividends received by German companies from non-EU subsidiaries for the purpose of German business tax. Under the relevant German rules, dividends from domestic shareholdings are exempt from German business tax, subject to a 15% minimum holding requirement. By contrast, with regard to foreign shareholdings, the exemption is subject to stricter rules since, in addition to the minimum holding requirement, the distribution must satisfy certain additional conditions (such as an active business test at the level of the distributing subsidiary). The German referring court (Finanzgericht Münster) asked the CJEU whether the German rules applicable to dividends from non-EU subsidiaries violate the free movement of capital envisaged in Article 63 and ff. of the Treaty on the Functioning of the European Union ("TFEU").

The AG concluded that (§ 62) the free movement of capital is applicable in the case at stake since the relevant German rules do not apply exclusively to situations in which the parent company exercises a decisive influence over the company paying the dividends. The AG also pointed out that such conclusion is not affected by the actual size of the investment in the company paying dividends.

AG excluded the applicability of the standstill clause envisaged in Article 64 of TFEU (§ 71). AG clarified that a 15% shareholding in the capital constitutes a "direct investment", which is one of the cases to which the standstill clause applies (§ 83). However, the AG found out that the current German rules on the taxation of foreign dividends are significantly different from those existing on 31 December 1993, as Germany abandoned the imputation credit system in favor of the exemption system starting from 1 January 2001 (§ 88). Thus the current dividends tax rules cannot be regarded as existing on 31 December 1993, which excludes the applicability of the standstill clause.

The AG finally denied that the restriction could be justified by the objective of combating tax avoidance and evasion. In this respect, he mentioned that it was undisputed that the relevant double tax convention permits an effective exchange of information (§ 101) and added that the taxpayer would not be in any case in a position to provide evidence of the lack an abusive construction in the State in which the dividends are sourced (§ 102).

If the conclusions of the AG were to be upheld by the Court, the judgment could impact on the Italian rules regarding the taxation of dividends from companies resident of low tax jurisdictions. Indeed, such dividends are, as a general rule, subject to full taxation (under certain conditions, a 50% exemption applies as from 2018) and do not benefit of the 95% exemption granted to domestic dividends.

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