

Foreign Tax Credits in Germany

The Court Ruling of Finanzgericht Rheinland-Pfalz
18.06.2021 – 3 K 1688/19

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Introduction

- A Foreign Tax can under certain condition be credited against German Tax on the respective item of income. The amount of the creditable foreign income is under the current treaties and unilateral German law **subject to any reduction available in the source state.**
- The court ruling deals with the question if a German resident is obliged to apply for the highest reduction of his tax liability available if the source state offers alternative methods to reduce a withholding tax (the treaty reduction and a unilateral reduction).

Legal frame – the DTT and the unilateral rules (1)

- DTT Germany – Norway (October 4, 1991) with Protocol (June 24, 2013)
- Art. 10 I: Germany as the plaintiff's state of residence may tax the dividend income
- Art. 10 II 1 HS 1 lit. a, lit b and III: Norway may tax the gross dividend at a rate of 15%
- Art. 23 II lit. b sub aa: Norwegian Tax paid levied in accordance with the Treaty and Norwegian Law is credited against German Tax on that income
- Art 28 I and II: Tax may be levied as a Withholding tax (WT) at a higher rate according to the unilateral law of the contracting states. An amount exceeding the treaty rate must be refunded to the recipient (beneficial owner) of that

Legal frame – The DTT and the unilateral rules (2)

- **Norwegian Law**

- **Nota bene:** Foreign tax law is treated in a German fiscal court proceedings as a legal fact and not applied as law by the German court. A German fiscal court has to evaluate the relevant facts.
- **Norwegian Skatteloven (§ 10 – 12 and § 10 – 13)**
- Norwegian tax on the dividend is levied by a withholding tax at 25% on the gross dividend.
- **Shielding deduction / Fradrag for skerming:** 0,4 % on the acquisition cost of the shares can be deducted from the dividend income or reduces the withholding tax [„interest allowance for corporate equity”]
- EU and EEA nationals were eligible to apply for the shielding deduction and could reduce the Norwegian tax liability

Legal frame – the DTT and the unilateral rules (3)

- **§ 32d V German Income Tax Act (ICTA) – free translation**

S 1: In ... the case of resident taxpayers

- who are subject to a tax equivalent to German income tax on foreign investment income
- in the state from which the investment income originates,
- the foreign tax assessed and paid on foreign investment income and **reduced by any claim arisen to a reduction,**
- but not more than 25 % foreign tax on the individual taxable investment income, **shall be credited against the German tax.**

S 2: **If a DTT provides for the crediting of a foreign tax,** including a tax deemed to have been paid, against the German tax, sentence 1 shall apply accordingly.

S 3: The foreign taxes shall only be credited up to the amount of the German tax due on the investment income received in the respective assessment period within the meaning of sentence 1.

Facts of the Case

- German resident (plaintiff) derived dividend income. Norwegian WT was deducted at a rate of 25%. A refund was granted under Art 28 II DTT (reduction from 25% to 15%).
- The plaintiff was denied any tax credit by the local German tax office.
- The German tax authorities argued that the entitlement to a tax shielding under Norwegian law had been available and would have completely reduced the Norwegian tax liability.
- The plaintiff would be obliged to opt for the highest reduction of Norwegian tax.
- Nature of dispute: appeal against the income tax assessment for 2017

Court`s Reasoning

- **Art 23 II lit b lit aa DTT** demands to credit such foreign tax which is levied in accordance with Norwegian Law and the treaty, and is already paid and does not entitle the taxpayer to a refund.
- **These conditions were met:**
 - The Court understood the Norwegian Law in the way that the plaintiff could have applied for the DTT reduction or the unilateral shielding deduction.
 - The Court further understood that once the taxpayer had opted for the DTT reduction the entitlement for the shielding deduction **lapsed retroactively**.
 - The DTT did not oblige the plaintiff to opt for the shielding reduction as a higher reduction method.
 - Under § 32d V S 1, 2 ICTA a claim to reduce Norwegian tax is only relevant if it has „arisen“:
 - **But:** the entitlement under the shielding deduction ceased to exist with retroactive effect once the DTT reduction was elected.
 - It could thus not be treated as a relevant ‘arisen claim’ under the section.
- Thus, the Norwegian WT effectively and rightfully levied under the DTT (15%) could be credited against the German tax

Conclusion

- The Court granted the German tax authorities a right to an appeal to the Bundesfinanzhof but no appeal was filed
- **Key takeaways from the ruling:**
- The DTT does not allow to credit Norwegian Tax **only** if it is lawfully levied and paid under the Treaty **and** if an option for a higher relief is available and elected. The latter condition **is not contained** in Art. 28 DTT.
- Any 'claim arisen' to reduce a foreign tax liability in the source state must in principle be considered under § 32d V German ICTA.
- **However**, such a claim has not 'arisen' if it ceases to exist retroactively once the DTT reduction method has been chosen.
- It is disputed in the literature whether the court's (pragmatic) interpretation is in line with the