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ISSUE:**REFUND OF GERMAN
WITHHOLDING TAXES ON
OUTBOUND DIVIDENDS****FOR MORE INFORMATION
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**INFRINGEMENT PROCEEDINGS OF THE EU COMMISSION
AGAINST GERMANY FOR THE TAXATION OF OUTBOUND
DIVIDENDS (2004/4349):
REFUND OF GERMAN WITHHOLDING TAXES TO NONRESIDENT
CORPORATIONS**

In infringement proceedings, the Commission of the EU has taken steps against Germany for a contravention of the free capital movement in violation of the EC Treaty (2004/4349) in that Germany withholds taxes on dividends paid to foreign EU corporations.

I. CURRENT LEGISLATION:

When a German company distributes dividends, a tax of 20% of the gross dividend is withheld as a rule. Unless reduced by current Double Taxation Conventions, foreign shareholders pay this withholding tax in final settlement. In contrast, dividends paid to German corporate residents are on balance tax-exempt since this tax is refunded to them when filing their tax returns in Germany. The EU Commission regards this rule as an unlawful discrimination of foreign dividend beneficiaries.

The taxation rule challenged by the Commission refers only to stakes of <10% held by corporate nonresidents since only in this case will an unlawful discrimination enter into consideration. Stakes above 10% in EU corporations are not subject to any withholding tax as the provisions of the Parent-Subsidiary Directive would apply.

**II. ALTERNATIVE RESPONSES TO THE
INFRINGEMENT PROCEEDINGS:**

- The Federal Government amends legislation to eliminate this discrimination, (i) either by harmonizing out bound-dividend taxation of corporate nonresidents holding <10% stakes so that their dividends will also be tax-free, or (ii) by taxing also the dividends paid to corporate residents (an approach already discussed when preparing the Annual Tax Law 2009).

- If Germany does not amend its tax legislation accordingly, the Commission's next step will be to refer the case to the European Court of Justice (ECJ) and move that the ECJ hold that national taxation in Germany is in this regard incompatible with EU law.

III. RETROSPECTIVE EFFECTS OF THIS PROCEDURE

Although the ECJ has not yet held that these German tax rules infringe EU law, this outcome is highly likely and will have a retrospective effect, howsoever Germany may or will resolve this issue. Therefore, corporate nonresidents holding stakes of <10% in German companies and on whose dividends German withholding tax had been deducted in the past, should definitely be entitled to claim the refund of such taxes.

Addressee of applications for the refund of withholding taxes on dividends to nonresidents is the Federal Central Fiscal Office ("Bundeszentralamt für Steuern"). Taxes are refundable until statute-barred after expiration of a 4-year period, meaning that taxes withheld for dividends which were received on or after January 1, 2004, are still refundable but German taxes on 2004 dividends become statute-barred after Dec. 31, 2008.

IV. RECOMMENDATIONS

We recommend that corporate nonresidents that since 2004 have paid such withholding taxes apply for refund. The application for refund of withholding taxes on dividends collected in 2004 must be filed on or before Dec. 31, 2008.

We further recommend that after receiving the Federal Fiscal Office's notice of denial (to be expected given the currently prevailing tax legislation), a notice of appeal be filed with reference to the pending infringement proceedings and the suspension of the refund procedure be applied for, due to administrative convenience under the terms of Art. 363(2) Clause 1 German Fiscal Code ("AO"), thus preventing any post-2003 claims from becoming statute-barred. Once the ECJ has formally held that this German taxation rule infringes EU law, any years for which an application for refund has been suspended will also benefit from a refund. However, if the infringement procedure is discontinued since the Federal Government has timely remedied the infringement by amending the related tax regulations, any nonresident taxpayer seeking refund would have to institute individual proceedings at their own cost and expense; the same approach must be taken if the Central Fiscal Office denies suspension and dismisses the appeal as unfounded.

If you prefer to be assisted in applying for the refund of withholding taxes, in formulating a notice of appeal, or in instituting legal proceedings, feel free to contact

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