European Tax Newsalert

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Germany

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Tax authority interpretative letter on revised German anti-treaty shopping regulations

Background

A foreign company that receives specific German-source income that is subject to German withholding tax (e.g., dividends, royalty or specific interest payments) may be entitled to relief under the European Union ("EU") Parent-Subsidiary Directive, the Interest and Royalty Directive, or any applicable double tax treaty or domestic tax law. In order to claim German withholding tax relief, the foreign company must document its compliance with the German anti-treaty shopping regulations.

Revisions to the anti-treaty-shopping regulations were effective January 1, 2012 (see our Newsalert dated December 7, 2011). On January 25, 2012, the German Ministry of Finance published a tax authority interpretative letter (dated January 24, 2012), reflecting the German tax administration's interpretation of the regulations.

Summary of the regulations

German withholding tax relief can (only) be claimed to the extent that:

1. the foreign company's shareholders would have been entitled to a refund or exemption had they received the income directly, or

2. the foreign company's gross receipts in the respective business year stem from own active business activities (“good receipts”), or

3. for those receipts that do not stem from the foreign company's own active business activities: (i) economic or other significant non-tax reasons exist for interposing the foreign company, and (ii) the foreign company has suitable business premises and equipment to participate in commerce (meeting these two requirements also results in “good receipts”).

The burden for proving that economic or significant other non-tax reasons exist and that sufficient substance exists rests explicitly with the foreign company.

As under the former regulations, the anti-treaty shopping regulations do not apply where the foreign company's principal class of shares is primarily and frequently traded on a recognized stock exchange, or where the German Investment Tax Act regulations apply to the foreign company.

Summary of the German tax administration’s interpretation

The revised regulations lacked clarity on how taxpayers should interpret the term “gross receipts from own active business activities”. The tax administration's interpretation has clarified this term, indicating that it refers to the foreign company's (entire) gross receipts and not just to the German-source income for which relief should be claimed.

If the foreign company has any receipts other than "good receipts" (i.e., "bad receipts"), the tax administration will grant relief on a pro-rata basis only. This applies regardless of whether the German-source income would form part of the foreign company's “good receipts” or "bad receipts".

The computation of the actual relief quota from German withholding tax under the apportionment scheme (*good receipts ÷ the foreign company's entire gross receipts*) increases in complexity when less than 100% of the foreign company’s receipts are “good receipts”. In addition, to qualify for further relief for the “bad receipts”, the taxpayer must analyze the next entity up the chain as if it received the German-source income directly.

The qualification of the foreign company’s receipts as “good” or “bad” is one of the decisive determinants for the relief quota computation and will likely become one of the main dispute areas.

The foreign company must notify the German Federal Central Tax Office if it holds a certificate of exemption and if there is a reduction in its eligibility for relief. Based on the tax authority interpretative letter, the notification requirement does not apply below specific de minimis thresholds.

An applicable double tax treaty with a concluding anti-abuse provision suspends the German anti-treaty shopping regulations.

Considerations in light of EU law, constitutional law and/or treaty override aspects

Based on the tax administration's interpretation, (full) German withholding tax relief may be partially denied if the foreign company has "bad receipts". This could occur even if there is no abuse with respect to the German-source income.

If the German-source income qualifies as "good receipts", the foreign company may nevertheless be entitled to full German withholding tax relief, if a (partial) denial from withholding tax relief for non-abusive structures infringes upon EU law or tax treaty law. Whether such override of EU law and double tax treaties as drawn from the tax authority interpretative letter was originally intended when the regulations were introduced appears questionable. The respective future discussion needs to be monitored.

Conclusion

The tax administration's interpretation may, in many cases, negatively impact the relief when compared to the former regulations. In addition, the relief quota determination is more complex when multiple-tier structures are involved.

If, at the time of payment, the recipient relies on a certificate that contradicts the legal status in force, and that reliance results in tax underwithholding, the German tax administration may levy additional tax on the recipient.

Companies should monitor developments on non-abusive structures.

For more information, please do not hesitate to contact:

Your international tax service team in the US

Kais Mouldi	+1 646 471 8811	k.mouldi@us.pwc.com
Bjorn Viebrock	+1 646 471 7858	bjorn.viebrock@us.pwc.com
Thomas Loose	+1 646 471 0483	thomas.x.loose@us.pwc.com
Jan-Philip Gehlhaar	+1 646 471 6532	jan-philip.x.gehlhaar@us.pwc.com

Your international tax service team in Germany

Stefan Brunsbach	+49 69 9585 6319	stefan.brunsbach@de.pwc.com