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NewsAlert

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Germany/Luxembourg *April 2012*

New Double Tax Treaty signed between Germany and Luxembourg

On 23 April, Germany and Luxembourg signed a new double tax treaty, which is to replace the original treaty dating back to 1958. The new treaty is aligned to the OECD model, representing an internationally recognised standard. For real estate businesses, the most significant change is the introduction of a real estate-rich companies clause.

More broadly, other clauses have been implemented with a view to eliminating situations where "double non-taxation" of income might otherwise occur – this is consistent with other more recently modernised German treaties, with for example the Netherlands and the UK. Also, not surprisingly, fund vehicles have received particular consideration.

Withholding taxes

Dividend withholding tax – the lower treaty withholding tax rate (available where the participation is held by a company) is to be decreased from 10% to 5%. The standard treaty rate is to remain unchanged at 15%. The reduced rate applies to participations of 10% or more, whereas under the current treaty a holding of 25% or more is required.

Interest withholding tax – no change is to be made to the current treaty rate of 0%.

Royalty withholding tax – no change is to be made - royalty payments are to remain subject to a 5% reduced withholding tax.

Explicit treaty access for funds

Luxembourg investment funds having the legal form of a SICAV, SICAF or SICAR (the SICAR has been explicitly defined as such in the protocol to the treaty) are to be eligible to claim treaty benefits in their own name. This means that they are to be entitled to a 0% withholding tax rate on interest and a 15% withholding tax rate on dividends.

Investment funds of a contractual type (i.e. FCP and Sondervermögen) are to be entitled to treaty benefits only to the extent they are held by residents of the territory where the fund is set up - for example, one would look at the German investors in a German contractual fund.

Permanent Establishments

Building sites, and construction and installation projects, are to definitely constitute a permanent establishment providing that their duration exceeds 12 months. Under the current treaty the limit is only 6 months.

Real Estate

No changes are made to the general approach, which is that capital gains arising on disposal of real estate are taxable only in the country where the real estate is located.

However, the new treaty also provides that gains from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in a Contracting State may be taxed in that State.

Dividends

Dividends paid by a Luxembourg company to a German corporate shareholder are to be exempt from tax in Germany where the shareholder holds a participation of 10% or more, where the dividends have not been deducted from the taxable basis of the Luxembourg company, and where the Luxembourg company conducts an "active" business within the meaning of the German CFC rules ("exemption method"). In all other cases, Luxembourg withholding taxes on dividends paid to a German shareholder may generally be credited against the German (corporate) income tax ("credit method").

Luxembourg will apply the exemption method as a general principle.

Avoidance of double taxation and double non-taxation

Generally, any type of active income derived from the other contracting state is to be tax exempt in the state of residency. However, Germany will apply the exemption method only if the income is effectively taxed in Luxembourg.

The new treaty not only provides for a mutual agreement process, but also for an arbitration procedure. Moreover, the new treaty explicitly allows both states to apply domestic law anti-abuse measures.

Protocol

Germany is to reserve the right to tax income from rights and receivables providing for a participation in the profit of the issuer, from silent partnerships, and from profit participating bonds under its own rules in cases where the relevant payment has been deducted from the profit of the debtor/issuer.

Luxembourg is to treat as dividends all income from obligations, which as well as a fixed interest rate also carry a variable interest rate related to the profit of the debtor/issuer. This is also to be the case for income from silent partnerships.

Entry into force

The new treaty will enter into force as soon as it has been ratified by both countries, and will basically be applicable as from 1 January of the year following the date of the ratification - i.e. probably 1 January 2013, assuming both national legislators act during 2012.

Our View

The new double tax treaty comprises a full revision, and hence needs to be analysed in detail. Naturally, the new rules need to be considered in the context of specific real estate investment and fund structuring goals, from both a German and a Luxembourg tax point of view.

However any restructuring needs also to reflect the respective current domestic tax legislation before one can properly assess the tax impact on any particular investment.

For more information, please contact your local PwC real estate tax service provider or one of the contacts below

Global

Uwe Stoschek
Global Real Estate Tax Leader
+49 30 2636-5286
uwe.stoschek@de.pwc.com

Europe, Middle East and Africa

David Roach
Real Estate Tax Leader - EMEA
+352 49 48 48 3057
david.roach@lu.pwc.com

Central Eastern Europe

Glen Lonie
Real Estate Tax Leader - CEE
+420 251 152 619
glen.lonie@cz.pwc.com

Americas

Paul Ryan
US Real Estate Tax Leader
+1 646-471-8419
paul.ryan@us.pwc.com

AsiaPacific

KK So
Real Estate Tax Leader - AsiaPac
+852 2289 3789
kwok.kay.so@hk.pwc.com

Nationally

Germany

Uwe Stoschek
+49 30 2636-5286
uwe.stoschek@de.pwc.com

Dr. Michael A. Müller
+49 30 2636-5572
mueller.michael@de.pwc.com

Helge Dammann
+49 30 2636-5222
helge.dammann@de.pwc.com

Dr. Hans-Ulrich Lauermann
+49 69 9585-6174
hansulrich.lauermann@de.pwc.com

Sven Behrends
+49 89 5790-5887
sven.behrends@de.pwc.com

Marcel Mies
+49 211 981-2294
marcel.mies@de.pwc.com

Alexander Lehnen
+49 40 6378-2136
alexander.lehnen@de.pwc.com

Luxembourg

Alexandre Jaumotte
+352 49 4848 5380
alexandre.jaumotte@lu.pwc.com

David Roach
+352 49 4848 3057
david.roach@lu.pwc.com

Oliver Weber
+352 49 4848 3175
oliver.weber@lu.pwc.com