TIGHTER GERMAN ANTI-TREATY-SHOPPING RULES

The provisions of section 50d(3) of the German Income Tax Act (EStG) on preventing the abuse of treaty benefits (anti-treaty-shopping rules) are going to be revised. To achieve this, the draft Withholding Tax Relief Modernisation Act (AbzStEntlModG) adopted by the German government on 20 January 2021 contains a proposal that responds to the requirements of EU law. However, transposing the corresponding EU legislation would also lead to a significant tightening of the rules.

OVERVIEW OF THE AMENDMENTS

The key amendments introduced by section 50d(3) sentence 1 of the draft EStG can be summarised as follows:

› Personal relief entitlement can no longer be claimed if withholding tax relief could also be claimed in the case of an assumed direct investment by the shareholder of the interposed corporation, although this would not be based on the same tax rules, but eg on a corresponding rule in another double tax treaty (DTT).

› Under the planned anti-treaty-shopping rules, holding companies with little or no substance that do not perform any functions beyond the mere holding of investments may no longer benefit from any preferential treatment.

An exception applies if the foreign company can demonstrate that obtaining a tax advantage is not one of the main reasons for the interposition, or that the foreign company is listed on a stock exchange.

BACKGROUND

Based on the transposition into German law of the Parent-Subsidiary Directive (section 43b of the EStG), the Interest and Royalties Directive (section 50g of the EStG) and the preferential treatment afforded under the double tax treaties, certain taxpayers can claim relief from investment income tax (Kapitalertragsteuer) or withholding taxes by means of an exemption or reduction under section 50d(1) and (2) of the EStG. In order to prevent other persons who are not entitled to this relief from benefiting from the relief indirectly by interposing eligible taxpayers, the 'anti-treaty-shopping rules' were inserted into section 50d(3) of the EStG. If the conditions set out in section 50d(3) of the EStG are met, exemption or relief from withholding taxes will therefore be denied.

However, the ECJ already ruled that the predecessor provision of the current section 50d(3) of the EStG contravened EU law and came to the same conclusion with regard to the current provision in its judgment of 14 June 2018 (Case C-440/17, GS). Taking into account the subsequent ECJ rulings on 26 February 2019 (including Cases C-116/16, T Denmark, C-117/16, Y Denmark Aps), the lawmakers continue to see a need for action here and therefore now want to ensure that the anti-treaty-shopping rules in section 50d(3) of the EStG are compliant with EU law. The revision is also intended to transpose the requirements of the anti-abuse rule under Article 6 of the ATAD and BEPS Action 6.

THE PLANNED RULE IN DETAIL

Under section 50d(3) sentence 1 of the draft EStG, exemption or relief from withholding taxes will only be granted if the following conditions are met:

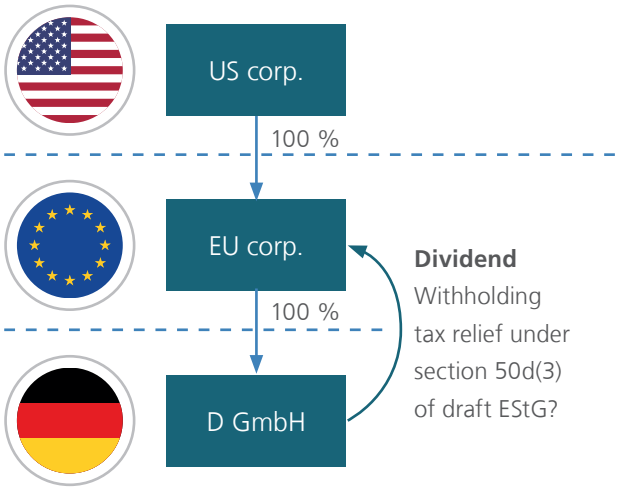
PERSONAL RELIEF ENTITLEMENT: ENTITLEMENT TO RELIEF IN THE CASE OF DIRECT RECEIPT

No DTT benefits are obtained if a corporation, association of persons or estate is interposed, to the extent that persons who would not be entitled to relief if they had received the income directly are invested in that entity, or benefit under the articles of association, the act of foundation or other constitution.

Compared with the previous rule, this is designed to clarify that not only companies, but all corporations, associations of persons and estates are covered by the rule. It also clarifies that not only persons who have an interest under civil law standards are covered, but also persons who, constructively, have an equivalent status.

According to the explanatory memorandum to the draft legislation, there is also no personal entitlement to relief if the person holding the investment or beneficiary would be entitled to the same amount of relief as the corporation, association of persons or estate, but the relief is the result of another DTT or another rule granting an entitlement. The same applies if a person holding a direct investment is entitled to relief under the EU Parent-Subsidiary Directive, but a person holding an indirect investment can only obtain relief on the basis of a double taxation treaty.

Example:



If the US corporation were directly invested in D GmbH, the tax to be withheld on dividend payments in Germany would be reduced to 0% under Article 10(3) of the Germany-USA DTT. However, the relief under the Parent-Subsidiary Directive that would be possible in the present case of an indirect investment would not be available in the case of a direct investment. In this example, the personal relief entitlement under section 50d(3) of the draft EStG must therefore be denied. In this respect, the next step is to examine the objective entitlement of the EU corporation to relief or the possibility of rebuttal (for more on this, see below).

OBJECTIVE ENTITLEMENT TO RELIEF: MATERIAL CONNECTION WITH AN ECONOMIC ACTIVITY

If the conditions for personal relief entitlement are not met, withholding tax relief may nevertheless be considered in situations where the source of income has a material connection with an economic activity of the corporation, association of persons or estate.

In this context, generating income that is transferred to persons holding an investment or to beneficiaries, as well as activities that are not performed using an adequate business operation, are not considered to be such an economic activity. According to the explanatory memorandum to the draft legislation, a holding company will continue to be considered as performing an economic activity if it systematically manages the fortunes of the subsidiaries as a holding company with active management functions. By contrast, an economic activity is no longer assumed if it merely involves 'passive investment management'. Contrary to this opinion, the ECJ has affirmed an economic activity in these cases (judgment of 14 June 2018, Case C-440/17, GS). The German Finance Ministry also currently assumes that investment management by a holding company is an economic activity, provided that the holding company effectively exercises its rights as a shareholder (German Finance Ministry circular of 4 April 2018). This positive interpretation for the taxpayer by the ECJ and the German Finance Ministry would therefore no longer be applicable following the amendment to German tax law.

REBUTTAL EVIDENCE: NONE OF THE MAIN REASONS FOR THE INTERPOSITION IS TO OBTAIN A TAX ADVANTAGE

In future, however, the corporation, association of persons or estate will be able to rebut the presumption of treaty abuse if sufficient non-tax reasons for the structure can be proven. Specifically, they must be demonstrate that none of the main reasons for interposing them is to obtain a tax advantage. According to the explanatory memorandum to the draft legislation, all non-tax reasons must be considered, even if they result from a group relationship.

In addition – similar to the previous rule – listed foreign companies will not be subject to the anti-treaty-shopping rule, provided that their shares are substantially and regularly traded on a recognised stock exchange. By contrast, the general exemption previously applicable to foreign incorporated investment funds will be deleted. For this reason, it will always be necessary to examine in future whether a foreign investment fund is covered by the new anti-treaty-shopping rules. However, section 50d(3) of the draft EStG is only relevant for reductions in investment income tax (Kapitalertragsteuer) to below 15% of domestic investment income because, under section 7(1) of the German Investment Tax Act (InvStG), the investment income tax, including the solidarity surcharge, is in any case only 15%.

INITIAL APPLICATION

As a general principle, the revised anti-treaty-shopping rules will apply to all open cases.

The situation is different if the version of section 50d(3) of the EStG in force at the time the income is received does not deny the claim to relief. According to the explanatory memorandum to the draft legislation, this is intended to avoid any inadmissible retroactive effect if the taxpayer is placed in a worse position as a result of the new rule. The revised anti-treaty-shopping rules come into force when the law is published.

WHAT YOU NEED TO DO

In addition to foreign companies, other corporations, associations of persons and estates that have limited tax liability in Germany should examine whether they can continue to obtain withholding tax relief following the planned revision of the anti-treaty shopping rules.

Since it is not currently possible to predict whether withholding tax relief can continue to be claimed on the basis of an existing exemption certificate if the requirements for withholding tax relief are no longer met under the new rules, the exemption certificates originally issued should be reviewed as a matter of urgency.

To avoid any negative consequences, domestic corporations with foreign shareholders should consider in the short term whether to make a distribution under the previous law before the new rules come into force.

Additionally, restructurings in the group may be necessary, eg by equipping a holding company with additional functions in order to ensure active investment management.

Finally, it will always be necessary to examine each individual case so as to identify any tax risks and to determine tax planning options.

CONTACT

Your designated contact persons are available to discuss the planned revision, and to identify any need for action and potential tax planning options.

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