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1. New Double Tax Treaty with Australia Signed

On 12 November 2015, Germany and Australia signed a new Double Tax Treaty (DTT Australia). The treaty is intended to replace the previous DTT Australia of 1972. The new DTT corresponds in the main to the OECD Model Tax Convention, but also contains deviating and additional provisions.

The personal scope of the DTT is supplemented by a provision covering income and profits derived by entities that are transparent for tax purposes (Art. 1 (2)). Under the DTT Australia, entities that are transparent for tax purposes are principally not entitled to treaty benefits, because they are not deemed residents within the meaning of Art. 4. However, pursuant to the new provision in Art. 1 (2), income, including profits derived through a transparent legal entity, is deemed to be income of a resident of one of the Treaty States to the extent that the income is treated, for the purposes of taxation by that Treaty State, as income of a resident of that Treaty State. Internationally, a comparable provision is contained in Art. 1 (7) DTT USA.

The new Art. 5 contains, inter alia, modified definitions for installation permanent establishments and agency permanent establishments. The latter are already defined with a view to the outcomes of the OECD BEPS project (see Final Report on Action 7 dated 5 October 2015: Preventing the Artificial Avoidance of Permanent Establishment Status). A dependent agent within the meaning of Art. 5 (8) may in particular be assumed where a person who is not authorized to conclude contracts habitually plays the principal role leading to the conclusion of such contracts. In addition, a person will not be deemed an independent agent within the meaning of Art. 5 (9), who acts exclusively or almost exclusively on behalf of one or several companies with whom he is closely affiliated.

In contrast to the German negotiating basis for DTTs, the new treaty does not implement the so-called Authorised OECD Approach (AOA) for determining the profits attributable to a permanent establishment (Art. 7 (2)) as outlined in the OECD Model Tax Convention 2010, but rather continues to focus on the dealing at arm's length principle contained in the OECD Model Tax Convention 2008 (for further information on the German negotiating basis see GTM edition of June 2013).

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Under the new DTT, withholding tax on dividends is applied at three levels. No tax on dividends may be withheld where the beneficiary of the dividends is a company (however not a partnership) residing in the other Treaty State and holding direct shareholdings in the dividend paying company. In this case, apart from other conditions, the shareholding has to grant at least 80% of the voting rights for a period of at least 12 months (Art. 10 (3)). It is admissible to apply a withholding tax rate of maximally 5% of the gross dividend amount to the extent that the company (with the exception of partnerships) holds at least 10% of the voting rights for at least six months in the dividend paying company (Art. 10 (2) a). In all other cases, the withholding tax rate must not exceed 15% (Art. 10 (2) b).

The general right to tax of the source state regarding interest continues to be limited to 10% of the gross interest amount (Art. 11 (2)). The agreed withholding tax rate deviates from the German negotiating basis for DTTs in the sense that it generally does not provide for the source state's right to tax interest. Regarding royalties the new DTT provides for a withholding tax rate of a maximum of 5% of the gross royalty amount (previously 10%; Art. 12 (2)).

To the extent that there is active income, Germany generally applies the exemption method for the avoidance of double taxation. However, the credit method is applied to passive income and certain other types of income, in cases of factual non-taxation in the source country or country of employment (subject-to-tax clause) or in cases of qualification conflicts (Art. 22).

In order to avoid abuse in general, the benefits of the new DTT are restricted where they exclusively serve the purpose of tax structuring or a tax transaction (limitation on benefits rule; Art. 23).

In addition, the DTT contains amended provisions regarding the exchange of information (Art. 26) as well as, for the first time, a provision on mutual agreement and arbitration proceedings (Art. 25) as well as a provision on mutual administrative assistance in tax collection (Art. 27).

The new DTT has not yet entered into force. It still requires the transposition into the national laws of both Treaty States and the subsequent exchange of the instruments of ratification in order to become effective. The legislative process for transposing the new DTT Australia into national law in Germany has not yet started. The Treaty will enter into force on the day of the exchange of the instruments of ratification and will be applicable for the first time on January 1 of the calendar year following the year of entry into force (Art. 32).

2. Federal Ministry of Finance: Income Tax Treatment of a Share-for-Share Deal with Cash Compensation

On 23 October 2015 the Federal Ministry of Finance (BMF) promulgated a draft dated 5 October 2015 regarding the income tax treatment of a share-for-share deal with cash compensation (§ 20 (4a) Income Tax Law (EStG). Accordingly, cash compensations associated with a share-for-share deal are subject to taxation also when granted to non-resident taxpayers.

Share-for-share deals with cash compensation occur mainly in cases of reorganizations involving corporations. If, for example, a corporation is merged into its sister corporation, the shareholders will receive shares in the receiving corporation in return for the cancelled shares in the transferring corporation. The shareholders of the transferring corporation may receive a cash compensation in addition to the shares.

Where a shareholder sells shares in a corporation or transfers them in exchange for other shares, German tax law principally provides for taxation of the resulting gain. Under certain conditions it is possible in a share-for-share deal to continue to carry forward the historical acquisition costs of the transferred shares for the shares received. Hence, no gain on the sale of the cancelled shares is realized. The conditions are in particular that the share-for-share deal is concluded based on an action under company law such as a merger resolution, that the German right to taxation regarding the gain on the sale of the shares received is not restricted, that the investor holds the shares as private assets, and that the investor holds less than 1 percent. The cash compensation, in contrast, is taxable as dividend and subject to withholding tax on income from capital (§ 20 (4a) EStG).

It is disputed whether the cash compensation paid to non-resident shareholders is also subject to taxation and withholding tax on income from capital in Germany. According to the BMF draft, the cash compensation generally qualifies as dividend and therefore also forms part of the taxable income of non-resident taxpayers in Germany. Consequently, the tax on income from capital has to be withheld.

3. Lower Tax Court of Saarland (1 K 1162/13): 5% Add-Back on Dividends also in Cases of Tax Exemption under a DTT

In its decision of 24 March 2015 the Lower Tax Court of Saarland ruled that dividends paid by a non-resident subsidiary which are covered by a participation exemption privilege under a Double Tax Treaty (DTT) are also subject to a 5% add-back of non-deductible business expenses.

For German Corporate Income Tax purposes, the dividends a corporation receives from a participation in a domestic or foreign corporation are principally tax exempt (§ 8b (1) Corporate Income Tax Law (KStG)). However, 5% of the dividends are deemed to be expenses which are not deductible as business expenses (§ 8b (5) KStG).

In the case at issue, A-GmbH (German Ltd.) resident in Germany held 100% of the shares in a subsidiary in China and 84.97% of the shares in a subsidiary in Turkey, from both of which it received dividends in the years at issue (2009-2011). A-GmbH argued that an add-back of deemed business expenses according to § 8b (5) KStG cannot apply in the case at hand, because the dividends must be (fully) exempt under a DTT participation exemption. This tax exemption would ultimately be undermined, if due to the add-

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back of the non-deductible deemed business expenses an effective taxation of 5% of the gross dividend were to occur.

The Lower Tax Court of Saarland dismissed the case and ruled that dividends which are tax exempt under a DTT are principally subject to a general add-back of 5% pursuant to § 8b (5) KStG. According to the Court, the exemption of the dividend under the DTT is not affected by the generalized 5% add-back rule. While it is true that this results in an effective taxation of 5% of the dividend income, this is an outcome which, according to the Lower Tax Court of Saarland, is supported by statutory provisions, because the taxation of the dividends occurs in several steps.

The first step is to verify whether the income is taxable or tax-exempt (according to a national or DTT participation exemption). The general 5% add-back is only applied in the second step. This is to ensure that (deemed) business expenses are not deductible to the extent that they are associated with tax-exempt income. This applies regardless of whether the dividends are tax-exempt based on national tax law or based on a DTT. In the view of the Court this does neither constitute a treaty override nor a breach of the Constitution.

The decision of the Lower Tax Court of Saarland is in agreement with a final judgment of the Lower Tax Court of Düsseldorf of 16 September 2014 (see January/February 2015 edition of German Tax Monthly). Appeal against the decision of the Lower Tax Court of Saarland has been filed with the Federal Tax Court and is still pending (I R 29/15). To date, there has been no Federal Tax Court (BFH) decision on the compatibility with DTT law of the add-back rules pursuant to § 8b (5) KStG authoritative in the case at issue. However, a decision of the BFH of 14 January 2009 (I R 47/08) suggested that the BFH's position is that the national exemption pursuant to § 8b KStG in the version of 2002 does not constitute a treaty override over an exemption granted by a DTT, because the scope governed by each of the Treaties remains unaffected by the national exemption.

4. Lower Tax Court of Munich (7 K 3250/12): Trade Tax Add-Back in Cases of Hiring of Exhibition Space

In a ruling of 8 June 2015, the Lower Tax Court of Munich decided that the rent paid for the temporary use of exhibition space in trade fair exhibition halls is subject to trade tax add-back.

Under German tax law a certain percentage of payments recorded as business expenses such as, inter alia, rents for immovable property, must be added back to the business profit when determining the profit for trade tax purposes. This means that a company's taxable income for trade tax purposes increases, with the tax burden rising accordingly.

The plaintiff is a special-purpose company arranging the participation of Germany and the Free State of Bavaria in trade fairs outside Germany. The Federal Republic of Germany and the Free State of Bavaria engage the special-purpose company to arrange and organize such trade fair participations for companies based in Germany or the Free State of Bavaria. The companies pay a share in the costs incurred by the special-purpose company in providing its services. For this purpose the plaintiff concluded contracts in its own name with trade fair organizers, particularly regarding the letting of exhibition space against payment. Furthermore, the special-purpose company also concluded contracts in its own name with the exhibiting companies for letting exhibition space against payment of a share in the costs.

In the context of a tax audit the German tax authorities expressed the view that the payments made to the trade fair organizers were rental payments for immovable property and therefore subject to trade tax add-back. The lower tax court followed this view. It interpreted the contracts concluded between the plaintiff and the trade fair organizers as rental agreements. The court also agreed that the payments are subject to trade tax add-back. Whether a trade tax add-back applies depends on whether the hired space would be considered a fixed asset if it were owned by the plaintiff (tenant), who would, according to this concept, take on the position of a "fictitious owner". According to the view of the court this is the case, because the exhibition halls are not meant for consumption or resale. On the contrary, the plaintiff requires the halls for its business activities, i.e. to accomplish its special purpose of arranging trade fair participations. The fact that the exhibition space is always only used for a short time does not change this view.

Appeal against the decision of the Lower Tax Court of Munich has been filed and is still pending (I R 57/15). Since the plaintiff's core business activity is to provide trade fair participations, it is questionable whether the case can be transferred to companies that only occasionally hire trade fair booths.

5. Lower Tax Court of Lower Saxony, 9 July 2014 (7 K 135/12): Controlling Company within the Meaning of the Group Exemption Provision on Real Estate Transfer Tax

Pursuant to German tax law, real estate transfer tax may be incurred during restructuring processes (e.g. in case of a merger of a corporation owning real property with another corporation), where these involve the transfer of domestic real estate property. According to the so-called "group exemption provision" (§ 6a Real Estate Transfer Tax Law (GrEStG)) an exception is possible. In this regard the law stipulates that no real estate transfer tax is incurred, inter alia, where the restructuring involves several "controlled companies", in all of which a "controlling company" holds shares. A company is deemed to be "controlled" within the meaning of the group exemption provision on real estate transfer tax if the controlling company holds at least 95% of its shares. The shares have to have been held without interruption for five years prior to the completion of the restructuring and have to continue to be held for five years after the completion of the restructuring. However, the group exemption provision does not contain a definition of the "controlling company". So far it has, in particular, been controversial,

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whether the term “Unternehmen” (meaning business or company) was to be interpreted in the sense of “business” as defined in the Value Added Tax Law (UStG).

Regarding this question the Lower Tax Court of Lower Saxony decided in a ruling of 9 July 2014 that a financial holding company which carries on business activities only through its subsidiary and which therefore is itself not a business within the meaning of the UStG, may indeed be a controlling company for purposes of § 6a GrEStG. According to the view of the court, the definition of a controlling company ensues from the provision itself, without having to consider any other provisions of the GrEStG or the UStG. Hence, what is meant by “controlling” is determined as logical complement from what is defined as “controlled” pursuant to § 6a GrEStG.

The Lower Tax Court of Lower Saxony explicitly disagrees with the view of the Lower Tax Court of Münster (judgment of 15 November 2013, 8 K 1507/11), which distinguishes between “abhängige Gesellschaften” (“controlled companies”) and “herrschenden Unternehmen” (“controlling businesses”) and allows for the application of the group exemption provision for real estate transfer tax purposes only for businesses within the meaning of the UStG as “controlling businesses”. Furthermore, the judgment passed by the Lower Tax Court of Lower Saxony is in disagreement with the view of the tax authorities [identical directives of the tax authorities of the German Federal States of 19 June 2012 (Federal Tax Gazette I 2012, p. 626)].

Since appeal against the decision has been filed with the Federal Tax Court (BFH) (I R 63/14) it remains to be seen how the BFH will decide.

6. International Information Exchange

Automatic Exchange of Financial Account Information

On 12 November 2015, the Bundestag (lower house of the German Parliament) adopted the Law on the Multilateral Competent Authority Agreement of 29 October 2014 (UmsetzGFKAustG) and the Law on the Automatic Exchange of Financial Account Information in Tax Matters and on Amendments of Further Laws (FKAustG). These are intended to ratify the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (CRS MCAA) of 29 October 2014 and to regulate the information exchange procedure in Germany (see September 2015 edition of German Tax Monthly).

Apart from the provisions regulating the exchange of information, it was decided that when winding up an open-ended real estate fund for domestic real property, unlike in the past, the real estate transfer tax no longer has to be paid twice.

Federal Ministry of Finance Guidance on Tax Information Exchange Agreements

On 10 November 2015 the Federal Ministry of Finance promulgated an application guidance in connection with the Tax Information Exchange Agreements that Germany concluded. According to this guidance, an exchange of information will only be carried out upon request. It is principally also possible to request information for periods prior to the entry into force of the relevant agreement. However, this does not apply to the agreements with Liechtenstein, Bermuda, and the Bahamas. The BMF guidance describes the necessary procedures for an exchange of information and for administrative assistance or legal assistance. It further explains the conditions under which foreign civil servants may be present during investigation activities in Germany and the rights they have while they are present.

7. Amendments to German Double Tax Treaties

In the following, we would like to give an overview of the most recent developments regarding the German Double Tax Treaties (DTT).

DTTs that have entered into force

Norway:

The amending protocol to the DTT Norway dated 24 June 2013 entered into force on 3 February 2015 and has been applicable since 1 January 2015. See August 2013 edition of German Tax Monthly for content of the amending protocol.

Netherlands:

The new DTT Netherlands dated 12 April 2012 will enter into force on 1 December 2015 and will be applicable starting from 1 January 2016. The content of the new DTT corresponds in the main to the OECD Model Tax Convention. The changes compared to the old DTT relate primarily to the introduction of the Authorised OECD Approach for the purpose of allocation of income from permanent establishments, withholding tax rates for dividends, introduction of a switch-over clause from the exemption method to the credit method for passive income from permanent establishments, and a rule regarding the comprehensive exchange of information.

DTTs which have been signed and transposed into German law but will only enter into force upon exchange of the instruments of ratification

Uzbekistan:

The amending protocol to the DTT Uzbekistan was published in the Federal Law Gazette on 13 October 2015. However, the instruments of ratification have not been exchanged yet. The amendments refer mainly to the exchange of information and administrative assistance in tax collection.

DTTs that were signed but not yet transposed into German law

DTT China:

On 11 November 2015, the finance committee of the German parliament published the recommendation to approve the law on the DTT China, which had been signed on 28 March 2014. The promulgation in the Federal Law Gazette and the exchange of the instruments of ratification are still pending. See May 2014 edition of German Tax Monthly for content of the new DTT China.

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DTT France:

On 26 November 2015 the law on the additional agreement to the DTT France, which had been signed on 31 March 2015, was promulgated in the Federal Law Gazette. The exchange of the instruments of ratification is still pending. See May 2015 edition of German Tax Monthly for content of the additional agreement.

DTT UK:

On 26 November 2015 the law on the amending protocol to the DTT UK, which had been signed on 17 March 2014, was promulgated in the Federal Law Gazette. The exchange of the instruments of ratification is still pending. The amendments relate to the introduction of the Authorised OECD Approach for the purpose of allocation of income from permanent establishments as well as to the right to tax remunerations for work in the public service.

DTT Ireland:

On 26 November 2015, the law on the amending protocol to the DTT Ireland, which had been signed on 3 December 2014 was promulgated in the Federal Law Gazette. The exchange of the instruments of ratification is still pending. The amendments relate to the introduction of the Authorised OECD Approach for the purpose of allocation of income from permanent establishments as well as to profits derived from operating ocean-going vessels and aircrafts.

DTT Israel:

On 26 November 2015, the law on the new DTT Israel, which had been signed on 21 August 2014, was promulgated in the Federal Law Gazette. The exchange of the instruments of ratification is still pending. See November 2014 edition of German Tax Monthly for content of the new DTT Israel.

DTT Jersey:

On 26 November 2015, the law on the DTT Jersey, which had been signed on 7 May 2015 was promulgated in the Federal Law Gazette. The exchange of the instruments of ratification is still pending. The new DTT follows the previous DTT with identical content and will be applicable upon entry into force on the day following the expiry of the old DTT.

There haven't been any changes since the last communications in the August 2015 and April 2015 editions of German Tax Monthly regarding the DTTs with Japan, Costa Rica, the Philippines, and Oman.

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