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NewsAlert

Real Estate Tax Services

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Relief from German withholding taxation for non-resident parent entities tightened

Following an EU infringement procedure against Germany, German legislator changed the provision granting relief from withholding taxation on dividends paid to a non-resident parent company under a Double Tax Treaty or the Parent Subsidiary Directive. The new set of rules applies as of 1 January 2012. The German Ministry of Finance issued a decree dated 25 January 2012 in which it lays down its interpretation of the new rules, which in many cases tightens the requirements for WHT relief.

New regulations

The revised provision affects all non-resident parent entities seeking relief from German withholding tax on dividends or licences from German subsidiaries. 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:

- economic or other significant non-tax reasons exist for interposing the foreign company, and
- the foreign company has suitable business premises and equipment to participate in commerce (meeting these two requirements also results in "good receipts").

The restrictions do not principally apply for foreign corporations which are either (i) listed at a stock exchange or (ii) qualify as investment corporations in terms of Sect 2 (5) InvA which falls under the reign of the German Investment Tax Act.

Limited relief in case of partial "bad receipts"

The wording of the new provision is ambiguous. It is consequently unclear whether the revised provision would restrict

or facilitate the WHT relief. The interpretation of German tax administration in its decree dated 25 January 2012 is such that it will restrict the WHT relief in many cases.

The new provision differs between so-called "good" and "bad" receipts (see below) of the non-resident parent. If the parent has any receipts other than "good receipts" (i.e., "bad receipts"), the tax administration will grant relief on a pro-rata basis only on the “good” and “bad receipts.

The computation of the actual relief quota from German withholding tax is based on an apportionment, namely *good receipts ÷ the foreign company's entire gross receipts*. The computation of the relief is based on the global receipts of the non-resident parent of the full fiscal year. According to the view of the tax authorities the income tests refer to the foreign company's entire (worldwide) gross receipts and not just to the German-source income for which relief should be claimed.

"Own active business activities" according to the decree

"Active business activities" require, according to the tax authorities, a participation in the market (active, permanent and sustainable). This can be generated, for example, by engagements with related entities for adequate consideration, such as acting as a management holding company. In contrast, mere shareholding in subsidiaries without active management is regarded as passive activity. Active income is furthermore excluded if activity is implemented via service providers (law firms, domiciliation agent etc.).

Relief for receipts from "passive activity" in terms of the revised provision

Any receipts that do not stem from own active activities qualify as "good receipts" if (i) there are "significant non-tax reasons" for interposing the foreign company, and (ii) the foreign company has suitable business premises and equipment to participate in commerce.

The decree interprets both requirements in a restrictive manner. It expressly states that circumstances based on the structure of a group of company do not qualify as "significant non-tax reasons". Hence, strategy or structure of the group, coordination, client relations, cost or mere preference of the location, coordination, organisation and group's planning do not suffice to fulfil this term.

As a further requirement, the foreign company needs to have sufficient substance in its country of residence. This demands that the company has qualified personal, office, technical equipment, phone line etc. that is adequate for the respective business and enables the company to participate in the market. Transactions between related parties need to be at arm's length.

Our View

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.

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.

The revised provision and especially its interpretation by the German administration once again raise serious concerns in view of EU law and are presently widely estimated by German professional tax literature to infringe EU law. It might therefore be possible to proceed against a denial of WHT relief on the grounds of EU law infringement.

Respective tax planning to meet these required should be analysed at the beginning of a fiscal year such that the income stream of the non-resident parent can still be affected.

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

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