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NewsAlert

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New Double Tax Treaty signed between Germany and the Netherlands

On 12 April, Germany and the Netherlands signed a new double tax treaty, which is to replace the original treaty which dates back to 1956. 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 income is not taxed in either state – this is consistent with other more recently modernised German treaties, with for example Luxembourg and the UK. Also, not surprisingly, treaty access is granted to investment funds.

Withholding taxes

No change is to be made to the current favourable treaty rate of 0% for interest and royalty withholding tax.

Also the standard treaty rate for dividend withholding tax is to remain unchanged at 15%.

A new maximum rate of 10% is applied where the dividend recipient is a Dutch resident pension fund. German resident pension funds are not eligible for this rate.

The lower treaty withholding tax rate (available where the participation is held by a company but not a partnership) is to be decreased from 10% to 5%. The reduced rate applies to share holdings of 10% or more, whereas under the current treaty a holding of 25% or more is required.

Note that holdings by taxable German companies of 5% or more in a taxable Dutch company would in principle be eligible for the Dutch domestic withholding exemption. In this case the 5% treaty rate is not relevant.

Treaty access for investment funds

Under certain requirements investment funds of a contractual type (i.e. *Dutch Fonds voor Gemene Rekening and German Sondervermögen*) are to be entitled to treaty benefits 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. Note that the fund manager is entitled to make the request on behalf of the investors.

Permanent Establishments

Building sites, and construction and installation projects, are to definitely constitute a permanent establishment providing that their duration exceeds 12 months. No change is to be made to the current treaty in this respect.

Capital Gains

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

However, the most significant change is the introduction of a real estate-rich companies clause. The new treaty also provides that gains from the alienation of non-listed shares deriving more than 75% of their value directly or indirectly from immovable property situated in a Contracting State may be taxed in that State. An exception is included for shareholdings below 50% as well as for reorganisations, mergers and demergers.

In the case of shares which derive their value from underlying German real estate this may result in the gain being taxed in Germany. Corporate investors may apply the German domestic participation exemption and thus only 5% of the capital gain is taxed in Germany at a rate of 15.825 %.

Where the shares derive their value from Dutch real estate, the capital gain may be taxed in the Netherlands. However, under domestic law the Netherlands would typically not tax this gain (unless Dutch substantial interest taxation applies).

Dividend income

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

The Netherlands will apply the exemption method as a general principle.

Avoidance of double taxation and double non-taxation

Germany will apply the exemption method for Dutch income only if the income is effectively taxed in the Netherlands. Consequently, rental income and capital gains which are not subject to tax in the Netherlands will not be exempt from taxation in Germany.

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 is deductible from the profit of the debtor/issuer.

The Netherlands is to treat as dividends all income from subordinated debt with a maturity of 50 years or more, which has an interest rate related to the profit of the debtor/issuer.

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 2014 given the expectation that Dutch parliament will not ratify until 2013 as a result of the upcoming elections.

Our View

The new double tax treaty is the result of substantial revisions, and hence needs to be analysed in detail. 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 Dutch 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 of the changes on any particular investment.

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

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