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Anti-treaty shopping regulation
 - dividends / royalties / interest payments -
 (Sec. 50d Para 3 Income Tax Act)

TAG Alliances Fall 2013 International Conference, Munich

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What we are talking about ...





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Tradition of treaty override

Income Tax Act

- Sec. 15 Para 1a, 17 Para 5, 20 Para 4a capital gains under EEC Taxation of Merger Directive)
- Sec. 48 d (construction withholding tax even in case of no domestic right of taxation)
- Sec. 50d Para 8 (fall back rule for salary income)
- Sec. 50d Para 9 (fall back rule in case of certain white income)
- Sec. 50d Para 11 (exclusion of affiliation privilege in case of certain hybrid-structured companies)
- Sec. 50i (taxation of certain partnerships with foreign partners))

German Foreign Transaction Tax Act

- Sec. 1 Para 5 s. 8 (subject-to-tax in relation to PE abroad)
- Sec. 7 Para 7 (investment vehicles)
- Sec. 20 Para 2 (switch to tax credit method in certain cases of PE abroad)

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Tradition of treaty override

Corporate Income Tax Act

- Sec. 8b Para 1 S.3 (exclusion of affiliation privilege in certain cases of PE abroad)

Reorganization Tax Act

- Sec. 13 Para 2, 21 Para 2 (securing of German Taxation under EEC Taxation of Merger Directive)

REIT-Act

- Sec. 16 Para 2 and 20 Para 4 (Exclusion of DTT-affiliation privilege and WHT-benefits for shareholders > 10%)

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Tradition of treaty override

Treaty override is not inhibited by ECJ:

Neither regarding Bilateralconvention for the avoidance of double taxation:

- Case C-336/96, 12 May 1998 - Gilly vs. Directeur des Service Fiscaux du Bas Rhin (France – Belgium Convention)
- Case C-128/08, 16 July 2009 – Dameseaux vs. Belgium (France – Belgium Convention)

Nor regarding art. 293, art 10 EC

- Case C-540/11, 19. September 2012 Levy and Sebbag vs. Belgium

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German WHT-relief framework (1)

German WHT-rates

- Dividends 26.375% incl. solidary surcharge
- Royalties 15.825% incl. solidary surcharge

Relief ...

- EU-Parent-Subsidiary Directive
- Interest and Royalties Directive
- Tax treaties

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German WHT-relief framework (2)

... can be obtained by

- application for a withholding tax exemption certificate (before the payment is made)
- request of a refund

Both forms are subject to the German anti-shopping rule

Competent body: Bundeszentralamt für Steuern, Bonn
(German Central Federal Tax Office)

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New regulation - Impacts

- Effect on 1 January 2012
- All qualifications according to German tax law
- Evidence shall be provided by the taxpayer
- WHT relief requirements more difficult to meet in practice
- Significant additional documentation obligations
- Difficulties namely for non-management-holding companies
- Consequence: cut of tax relief in part or in total

Key issue: - qualification of shareholder's business activities
- allocation of shareholder's earnings to it

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Purpose

Cayman Ltd.

EU-Corp.

German Corp.

←

Shareholder would not be entitled to a corresponding benefit if he had received the income directly

←

Meets formal requirements to benefit under tax treaty or an EU directive

Interest
Dividend
Royalties

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Shareholder test (1)

Stock Exchange listing - privilege

stock listed

||||

US - Corp.

↓

EU-Corp.

↓

German Corp.

Shareholder test (+)

Shareholder test (= personally entitled) (+)

↓

Full relief (no factual entitlement required)

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Shareholder test

Stock listed

||||

US - Corp.

↓

Cayman Corp.

↓

EU-Corp.

↓

German Corp.

Stock listed - privilege: meaningless

Personal (fictional) entitlement: meaningless

Shareholder test (-)

Shareholder test (+)

↓

No relief

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Business income test

If the shareholder test is passed (and no ultimate shareholder is listed):

„Which portion of to shareholding company's

- gross receipts

- in the relevant tax years

is generated from company's **genuine own business activities**?

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Genuine own business activities

1. Operative activities in a general trade

- Manufacturing

- Sales and distribution

- Services

(If rendered to group-members: under arm's length conditions)

⇒ "good income type A"

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Genuine own business activities

2. Holding companies: active management required

- Long term strategic decisions

- Fundamental decisions

- Documentation

- At least two subsidiaries

⇒ "good income type A"

not sufficient: - Majority in shares
- Mere use of shareholder's rights

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Genuine own business activities

3. Dividend payments: functional link to shareholder's own business

- manufacturer / distributor / supplier

⇒ „good income type A“

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„Last resort“

Earnings from own business activities

< 100%

Business purpose test

Are there **economic** or other **relevant reasons** for the interposition of the foreign company in relation to the relevant income?

+

Substance test

Does the company has **adequate business substance** to engage in trade or business in general commerce?

⇒ „good income type B“

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Business purpose

- Intention to set up genuine own business

- Legal aspects (e.g. separation of business compulsory)

- Economic aspects (refinancing)

- Religious aspects (obstacles for production of certain goods)

not sufficient:

- Tax reasons

- Securing the retirements of the shareholders

- Safeguard domestic assets in time of crisis

- Reasons resulting from circumstances of the group (very vague!)

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Adequate business substance

- Existence of sufficient management and other staff personal
- Sufficient qualification
- Sufficient equipment, facilities, a. s. o.

Not sufficient: substance at the level of other group companies

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Look-through approach

In case and to the extent of bad income:
→ Step up to the higher tier company

Provided, that company is personally entitled to the same level of WHT-relief

If only entitled to lower relief, the lower relief will be decisive insofar.

If entitled to no relief (= shareholder test (-)), no relief, no step up to next higher tier.

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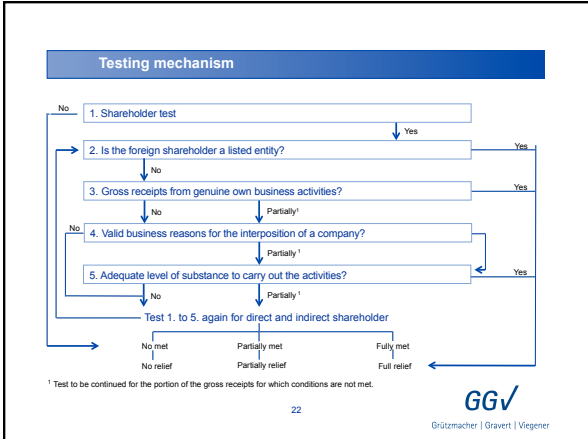
Apportionment rule

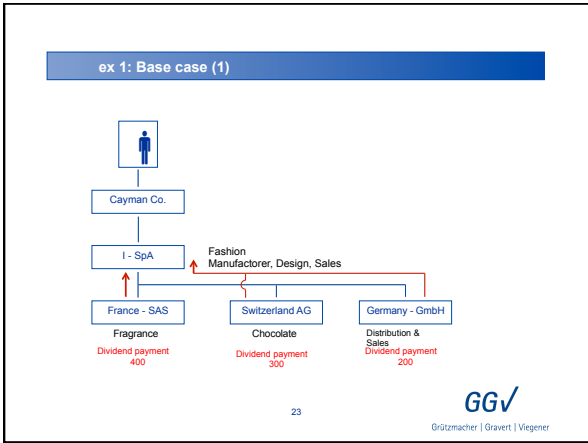
Entitlement: **pro rata**

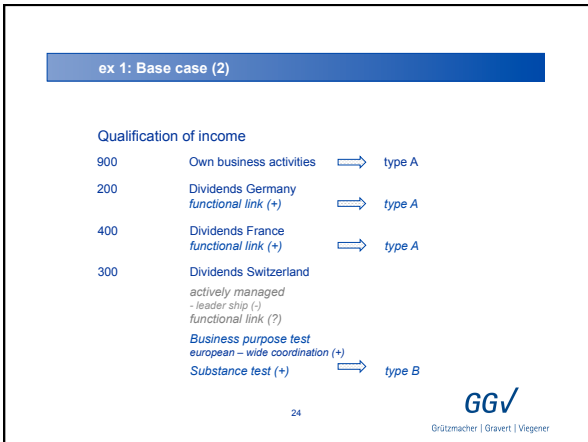
$$\frac{\text{sum of good income type A} + \text{sum of good income type B}}{\text{total gross receipts}} = \% \text{ of relief}$$

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ex 1: Base case (3)

Computation of tax relief

$$\frac{\text{type A (900 + 200 + 400) + type B (300)}}{\text{gross income 1800}} = \frac{1800}{100\% \frac{1800}{1800}} =$$

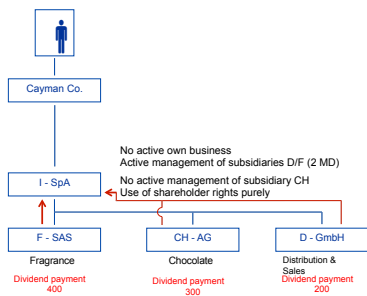


full tax relief

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ex 2: Holding (1)



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ex 2: Holding (2)

Qualification of income

200	Dividends Germany actively managed (+)	⇒	type A
400	Dividends France actively managed (+)	⇒	type A
300	Dividends Switzerland actively managed (-) functional link (-), Holding Substance test (-)	⇒	bad income

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ex 2: Holding (3)

Computation of tax relief

$$\frac{\text{type A (600)}}{\text{gross income 900}} = \frac{600}{900} = 66,66\%$$

↓
Partial relief $\frac{2}{3}$

Alternative: no dividend payment from CH

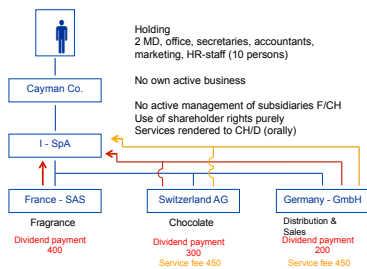
$$\frac{\text{type A (600)}}{\text{gross income 600}} = \frac{600}{600} = 100\%$$

pro: WHT-relief (D) $200 \times 26,375\% \times 1/3 = 17,5$
 contra: Lack of liquidity (CH) net div. $221 \times 2\% = 4,4$
 Benefit $= 13,1$

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ex 3: Inter – co services (1)



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ex 3: Inter – co services (2)

Qualification of income

900	Service fees (-)		
	arm's length principle (-)	⇒	bad income
200	Dividends Germany		
	actively managed (+)	⇒	type A
400	Dividends France		
	actively managed (-)		
	Business purpose test		
	Substance test (+)	⇒	type B Build – up of an own active business?
300	Dividends Switzerland		
	actively managed (-)		
	Business purpose test		
	Substance test (+)	⇒	type B Build – up of an own active business?

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ex 3: Inter – co services (3)

Computation of tax relief

$$\frac{\text{type A (200) + type B (700)}}{\text{gross income 1800}} = \frac{900}{1800} = 50\%$$

↓

Partial relief ½

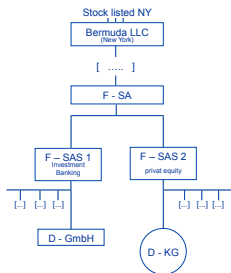
Alternative: Business purpose test (-)

$$\frac{\text{type A (200) + type B (0)}}{\text{gross income 1800}} = \frac{200}{1800} = 11,1\%$$

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ex 4: „Look through“ (1)



"European hub"
Strategic decisions are taken in
group-wide "division – boards"

SAS (1): shell (legal reasons)
SAS (2): staff runs business of F-SA

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Income qualification

Challenges ...

F - SAS (1) Shareholder test (+)

F - SA
Active management (-)
Only under a group perspective
→ invalid argument

Business purpose (+)
Capital market legal requirements for separation

Substance (-)

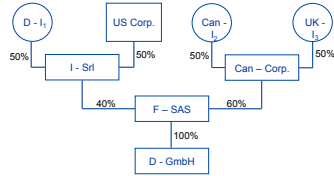
LLC
Shareholder test
- Bermuda determinant law vs. NY-seat
- Qualification of the legal form (partnership vs. corporation) disputable

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ex 5: „Look through“ (2)

Corporate structure¹



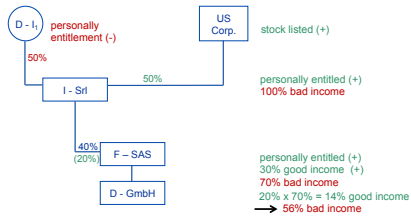
¹ Variant form of German Ministry of Finance, guidance 24. Jan. 2012, IV B 3 – S 2411/07/10016

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ex 5: „Look through“ (2)

Apportionment (1)

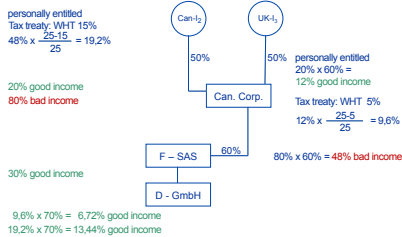


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ex 5: „Look through“ (3)

Apportionment (2)



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ex 5: „Look through“ (4)

	DTT rate reduction	good income		bad income	good income
		3rd tier	2nd tier	F-SAS	total
		50%	40% / 60%	70%	
originally good income_30%)		x	x		30,0%
I - Srl (0%)		x	0,0%	0,0%	0,0%
Can- Corp. (20%)	20 / 25	x	9,6%	6,7%	6,7%
US-Corp (100%)		50,0%	20,0%	14,0%	14,0%
D- Ind. 1 (0%)		0,0%	0,0%	0,0%	0,0%
Can-Ind 2 (80%)	10 / 25	16,0%	9,6%	6,7%	6,7%
UK - Ind 3 (80%)	10 / 25	16,0%	9,6%	6,7%	6,7%
					64,16%

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Things to keep in mind

- Dividend planning
- Strengthen active management
- Thorough documentation (holding)
- Make provision for written agreements in advance
(share service center, I/C-services)
- Reorganization (shareholder test, at least two subsidiaries et cetera)
- Notification: taxpayer is obliged to notify the tax authorities of relevant
changes in the gross receipts or shareholders (de minimis – clause)

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**Thank you very much
for your attention!**

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