



25. April 2012

Germany and Luxembourg have signed a new double tax treaty

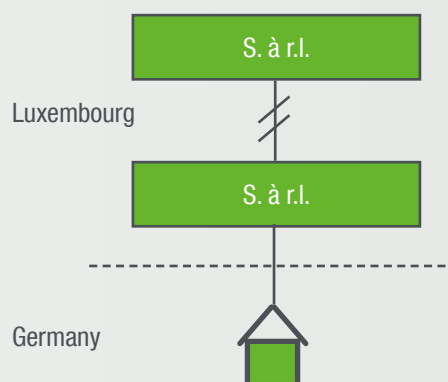
On 23 April 2012, Germany and Luxembourg signed a new income and capital tax treaty. The new double tax treaty will replace the existing double tax treaty which was concluded in 1958. The new double tax treaty will apply after confirmation by parliament but not before 1 January 2013.

Some highlights for your business and some important deviations from the existing rules are summarized below:

1. Income from immovable property

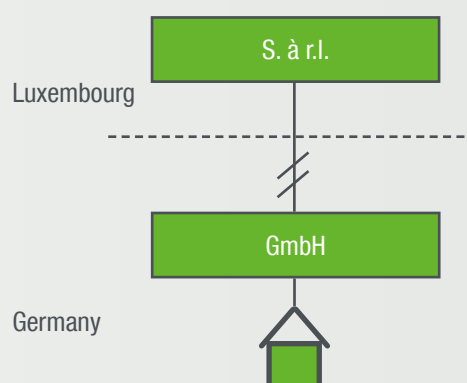
As under the currently existing rules, income from leasing and letting as well as capital gains from the sale of immovable property can be taxed in the country where the property is situated. To avoid capital gain taxation in Germany, often real estate had been held indirectly via a Luxembourg or via a German company. The alienation of the shares in both cases were not subject to capital gain taxation in Germany. The still existing treaty granted the taxing right to the state where the seller of the shares was resident. According to the new treaty capital gains realized upon disposal of shares in a company deriving more than 50% of their value (directly or indirectly) from immovable property situated in the other contracting state may also be taxed in the situs state of the immovable property.

With regard to direct investments in German real estate by a Luxembourg S. à. r.l. without a German permanent establishment, however, this new rule should not lead to disadvantageous tax consequences in Germany:



Although Germany is allowed to tax the capital gains from the sale of the shares in the Luxembourg S. à. r.l. under the new double tax treaty, according to German domestic tax law, such capital gains are not subject to tax in Germany.

Under the new treaty, however, attention has to be paid to the following case, in which the property is owned by a German GmbH whose shares are sold by a Luxembourg S. à r.l.:





Under the new double tax treaty, the taxing right for the capital gains from the sale of the shares in the GmbH is granted to Germany. Such capital gains are generally subject to tax in Germany, however, 95% thereof are exempted under the domestic participation privilege. Nonetheless, the Luxembourg S. à r.l. is now subject to limited tax liability in Germany and has to file a corporate tax return. Such filings were not necessary under the still existing double tax treaty.

2. Dividends

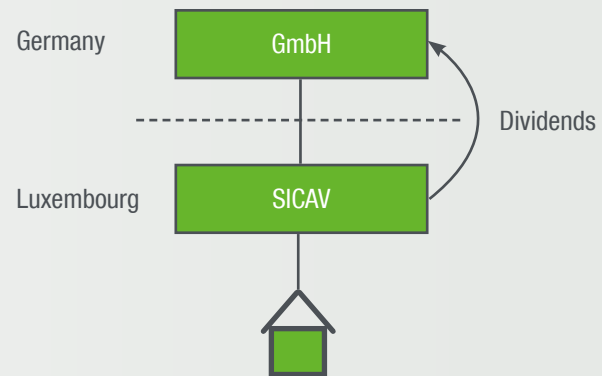
The general dividend withholdings tax rate remains at 15%.

With regard to the participation privilege under the double tax treaty, the withholding tax rate is reduced from 10% to 5%. Under the still existing treaty, the participation privilege only applies if the dividend receiving corporation owns at least 25% of the voting shares in the distributing corporation, whereas under the new double tax treaty, the participation privilege applies if the beneficial owner of the dividends is a company of the other contracting state holding at least 10% of the capital of the paying company. Thus, the new requirements of the participation privilege have adopted the requirements set forth in the EU Parent-Subsidiary-Directive. The Directive even allows for a 0% withholding tax on dividends and is therefore generally the more beneficial rule within the EU.

The new double tax treaty explicitly denies the participation privilege for dividends paid to an investment company. Investment companies within the meaning of the new double tax treaty should be the German Investmentaktiengesellschaft as well as the Luxembourg société d'investissement en capital à risque (SICAR), société d'investissement à capital variable (SICAV) and société d'investissement à capital fixe (SICAF). Dividend withholding tax at a rate of 15% is allowed.

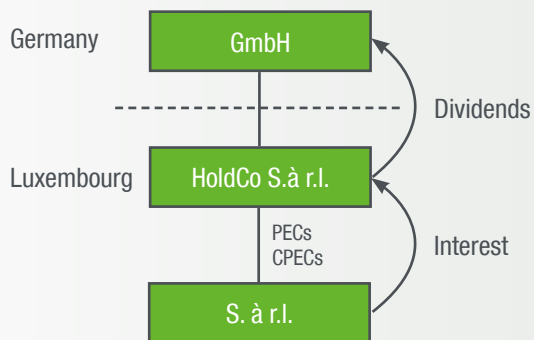
On the other hand, as under the still existing double tax treaty, dividends by an investment company generally allow for the application of the participation privilege. Deviating from this general rule, the new double tax treaty, however, makes

an exception for real estate investment companies, whose income is completely or partly exempt from taxation or which can deduct the distributions from its taxable income. In such a case, the 15% rate also applies, as in the following example.



However, according to Luxembourg domestic law, dividends by a SICAV are subject to a 0% withholding so that the withholding tax rate under the new double tax treaty is of no relevance in this case.

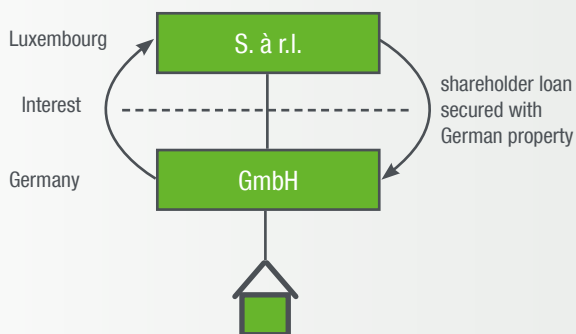
Germany generally applies the exemption method to dividend income qualifying for the participation exemption at the level of the recipient. Deviating therefrom, under the new double tax treaty, Germany applies the credit method if the dividend income was deducted from the taxable income of the distributing company or if the distributing company does not derive its income from active business within the meaning of the German Foreign Tax Act. To apply the exemption method for dividends qualifying for the participation privilege, thus, becomes more difficult under the new double tax treaty. For example, in the following case a German GmbH will not be exempt from taxation under the new double tax treaty, as interest income at the level of the distributing Luxembourg company would not qualify as active income:



In the end, however, the tax leakage is not burdensome: According to the German domestic participation privilege, the dividend income is 95% tax exempt for corporate income tax purposes as well as trade tax purposes at the level of the GmbH.

3. Interest

As under the existing double tax treaty, the new double tax treaty applies a 0% withholding tax rate for interest payments. Nonetheless as applicable today, the contracting states may deduct withholding taxes according to their domestic rules if they allow for a refund of such withholding taxes when applied for. Germany, for example, is thus allowed to withhold taxes on interest payments by a German subsidiary to its Luxembourg parent company at a rate of 25% under the condition that the shareholder loan is secured by German real property:



Under the preconditions set forth in Sec. 50d of the German Income Tax Act, Germany will refund such 25% German interest withholding tax due to the fact that Germany is not allowed to tax such interest under the still existing and the new the double tax treaty.

4. Summary

Even so the fact that a new treaty has been negotiated is new information, the content of the new double tax treaty as such does not contain any surprises considering the recent double taxation policy of the German government. Meanwhile, it is common practice to grant the taxing right for capital gains from the sale of shares in companies, which derive more than 50% of their value from immovable property in the other contracting state, to the situs state of the immovable property. Furthermore, within the EU, it is standard to adopt the requirements for the participation privilege to those set forth in the EU Parent-Subsidiary-Directive. In addition, Germany remains with its common practice to apply generally the exemption method when avoiding a double taxation. However, the new treaties include various clauses to avoid any form of treaty abuse, here in the new double tax treaty with Luxembourg: a subject-to-tax-clause, an activity clause as well as a switch-over-clause. Furthermore, the participation privilege is explicitly not applicable for hybrid financing instruments.

Existing inbound investments in German real estate have to be analyzed with regard to potential exit scenarios against the background of the new double tax treaty. However, as the participation exemption according to German national law provides for a 95% tax exemption for capital gains from the sale of shares even if the alienator is a foreign company, the revision of the capital gains clause for companies with immovable property should not be scaring for foreign shareholders. Additionally, there is sufficient time left to optimize the investment structures, as the new double tax treaty will apply at the earliest as of 1 January 2013.



be in touch: If you have any questions, please do not hesitate to contact us.



Dr. Carsten Bödecker

Partner . Steuerberater . Rechtsanwalt

Tel. +49 (0) 211 946847-51

Fax +49 (0) 211 946847-01

carsten.boedecker@bepartners.pro



Carsten Ernst

Partner . Steuerberater

Tel. +49 (0) 211 946847-52

Fax +49 (0) 211 946847-01

carsten.ernst@bepartners.pro



Holger Hartmann

Partner . Rechtsanwalt

Tel. +49 (0) 211 946847-53

Fax +49 (0) 211 946847-01

holger.hartmann@bepartners.pro



Nathalie Grenewitz

US-Attorney at Law

Tel. +49 (0) 211 946847-57

Fax +49 (0) 211 946847-01

nathalie.grenewitz@bepartners.pro



Friederike Schmitz

Steuerberaterin

Tel. +49 (0) 211 946847-60

Fax +49 (0) 211 946847-01

friederike.schmitz@bepartners.pro