



International Tax Alert

BDO Seidman, LLP
Accountants and Consultants

ISSUE:

NEW OPPORTUNITY CREATED BY GERMAN THIN CAPITALIZATION RULES

DATE: Effective January 1, 2004

AFFECTING: German companies with significant intercompany loans to U.S. subsidiaries

DETAILS:

As recently addressed in our Tax Alert entitled *New German Tax Law Changes to Severely Impact Businesses* dated January 8, 2004 the new German tax law contains *inter alia* changes relating to the thin capitalization rules. These changes were made in order to conform to EU Law, so as to eliminate the distinction between how the thin capitalization rules were applied to non-resident and domestic shareholders of German entities.

This rule may also benefit German parents of U.S. subsidiaries. More specifically, if a German parent loans to its U.S. subsidiaries, based upon the new rules, certain interest income of the German entity could be deemed dividend income. The dividend income could qualify for the 95 percent exemption by the German parent. Thus, if the payments made by the U.S. subsidiary are deductible interest for U.S. tax purposes, this financing may yield income tax benefits.

Consequently, in certain circumstances, and with careful implementation, strategic tax planning might work to successfully minimize the overall tax burden in Germany and the U.S. In summary, this could have the same income tax benefits as a hybrid loan without the harsh consequences otherwise imposed by the U.S./Germany income tax treaty on hybrid loans.

RECOMMENDED ACTION:

Our international tax consultants can assist you in determining how this new opportunity can apply to your financing arrangement. Well-versed in the changing German tax rules, we provide value-added, practical advice for a wide variety of multinational companies.

Material Discussed in this newsletter is meant to provide general information and should not be acted on without obtaining professional advice tailored to your firm's individual needs.

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