

AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

BDO KNOWS: INTERNATIONAL TAXATION

A PUBLICATION FROM THE BDO GERMANY/US TAX DESK



SUBJECT

POST-BASE EROSION AND PROFIT SHIFTING ("BEPS") TREATIES SIGNED BY GERMANY IN 2015

SUMMARY

Germany has signed new income tax treaties with Australia on November 12, 2015 ("Germany-Australia Treaty") and with Japan on December 17, 2015 ("Germany-Japan Treaty") (together "Post-BEPS Treaties"). The Post-BEPS Treaties lower or eliminate withholding tax rates on cross-border transactions and incorporate the provisions in the Organisation for Economic Co-operation and Development ("OECD") Model Convention as well as the OECD/G20 BEPS recommendations. The Germany-Australia Treaty replaces a previous tax treaty between Germany and Australia signed in 1972 while the Germany-Japan Treaty replaces a previous tax treaty signed in 1966. These Post-BEPS Treaties will enter into force once ratified.

BACKGROUND AND DETAILS

Major changes in the Post-BEPS Treaties

These Post-BEPS Treaties represent the first post-BEPS treaties between major economies that incorporate the main OECD recommended treaty changes. These changes include (but are not limited to): prevention of treaty abuse, dual residency rules and hybrid mismatch arrangements, discussed in more detail below.

Prevention of Treaty Abuse

In accordance with BEPS Action Item 6: Prevent Treaty Abuse, the preambles of the Post-BEPS Treaties clarify that their express purpose is to eliminate double taxation in the case of taxes on income and capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. The benefits of the Post-BEPS Treaties will be denied to those deemed to abuse its provisions. This is consistent with the principal purpose

CONTACT:

ROBERT PEDERSEN, Partner and
International Tax Practice Leader
(212) 885-8398 / rpedersen@bdo.com

JOE CALIANNO, Partner and International
Technical Tax Practice Leader
National Tax Office
(202) 904-2402 / jcalianno@bdo.com

ROBERT M. BROWN, Partner
(412) 281-6018 / rmbrown@bdo.com

SCOTT HENDON, Partner
(214) 665-0750 / shendon@bdo.com

MARTIN KARGES, Senior Director /
Germany Desk
(212) 885-8156 / mkarges@bdo.com

MONIKA LOVING, Partner
(404) 979-7188 / mloving@bdo.com

CHIP MORGAN, Partner
(310) 557-7517 / cmorgan@bdo.com

BRAD RODE, Partner
(312) 233-1869 / brode@bdo.com

WILLIAM F. ROTH III, Partner,
National Tax Office
(616) 776-3761 / wfroth@bdo.com

JERRY SEADE, Principal
(713) 986-3108 / jseade@bdo.com

test provided for under BEPS Action Item 6, which denies treaty benefits where the principal purpose of the transaction is to take advantage of Post-BEPS Treaties.

Nothing in the Post-BEPS Treaties will prevent either country from applying their domestic laws which are designed to prevent the evasion or avoidance of taxes.

Dual Residency Rules

The residency article of the Post-BEPS Treaties contains a new provision dealing with dual residency situations, including a tie-breaker rule that reflects BEPS Action Item 6 recommendations. In cases where a person, other than an individual, is a dual resident, the competent authorities of the Contracting States shall determine, by mutual agreement, the Contracting State of which the person shall be deemed to be a resident. This determination will take into consideration the place of management or head office, place of incorporation and any other relevant factors. In the absence of such agreement, a dual resident will not be entitled to the benefits of the Post-BEPS Treaties.

Hybrid Mismatch Arrangements

In line with the BEPS Action Item 2: Neutralize the Effects of Hybrid Mismatch Arrangements, Post-BEPS Treaty benefits will be available for income derived through fiscally transparent entities but only to the extent that the income is treated as the income of a resident of Japan, Australia, or Germany, respectively, under domestic law.

Some other notable changes to the Post-BEPS Treaties include:

- ▶ A ten year time limit will generally apply for making transfer pricing adjustments, subject to certain exceptions for negligence or willful or fraudulent conduct.
- ▶ The possibility for taxpayers to seek the revenue agencies' assistance in the resolution of tax disputes arising from the application of the Post-BEPS Treaties under mutual agreement procedures. Taxpayers will also have the ability to refer tax disputes that remain unresolved after two years to an independent binding arbitration.
- ▶ The broadening of the rule for exchange of taxpayer information.

Specific changes to the Germany-Australia Treaty

Permanent Establishment

Article 5 of the Germany-Australia Treaty includes the main BEPS Action Item 7: Preventing the Artificial Avoidance of Permanent Establishment Status, recommendation. The definition of "permanent establishment" has been expanded and supplemented by new provisions which will broaden the range of circumstances in which both countries can tax business profits. Article 5 has notably been updated to include proposed OECD amendments with regards to the substantial negotiation of contracts and the definition of independent agents. In accordance with the OECD recommendations, the Germany-Australia Treaty narrows the preparatory or auxiliary activity exception.

Withholding Tax Rates

Under the Germany-Australia Treaty, dividends may be taxed in the source country of the dividend subject to the following limitations:

- ▶ Zero percent for intercorporate dividends paid to publicly-listed companies or their subsidiaries, or unlisted companies in certain circumstances, that hold 80 percent or more of the voting stock of the paying company;
- ▶ Five percent of the gross amount of the dividend for intercorporate dividends paid to companies that hold at least ten percent of the paying company's voting stock for at least 6 months;
- ▶ 15 percent for all other dividends.

The Germany-Australia Treaty provides for a Ten-percent withholding tax rate for interest, with an exemption for interest derived by government bodies, central banks and unrelated financial institutions.

The withholding tax rate for royalties will be five percent.

Specific changes in the Germany-Japan Treaty

Treaty Abuse and Permanent Establishment

Consistent with BEPs Action Item 6 recommendations and in addition to the principal purpose test, the Germany-Japan Treaty includes objective tests that would determine whether a person should be considered as a qualified person by satisfying certain conditions. If such conditions are met, they would be entitled to the benefits of the Germany-Japan Treaty.

A new approach to calculate income attributable to permanent establishment has been introduced in the Germany-Japan Treaty. These provisions of the Germany-Japan Treaty are consistent with Article 7 of the OECD Model Convention.

In addition, a “switch-over” clause has been introduced, which allows Germany to apply the tax credit method to cases where Germany exempts income received by a German resident if there is a treaty qualification conflict.

Withholding Tax Rates

Under the Germany-Japan Treaty, dividends may be taxed in the source country of the dividend, subject to the following limitations:

- ▶ Zero percent where the corporate shareholder holds at least 25% of the voting stock of the paying company for at least 18 months;
- ▶ Five percent where the corporate shareholder holds at least 10% of the voting stock of the paying company for at least six months;
- ▶ 15 percent in all other cases.

The Germany-Japan Treaty provides for a withholding tax exemption for interest and royalty payments.

BDO INSIGHTS

The Post-BEPS Treaties will enter into force after the contracting countries have completed their domestic requirements and instruments of ratifications have been exchanged.

Multi-National Companies and Investors that rely upon the Germany-Australia or Germany-Japan Treaty should review their existing structures and ensure that important benefits may still be available under the Post-BEPS Treaties provisions, or even new benefits could be claimed. Envisioned structures and future transactions will need to be analyzed with the Post-BEPS Treaties in mind.

BDO international tax specialists can advise of these matters and help to find the most efficient structures.

This alert has been prepared in consultation with BDO International member firms for general informational purposes only and should not be construed as tax advice. As such, you should consult your own tax advisor regarding your specific tax matters.

The Tax Practice at BDO is among the largest tax advisory practices in the United States. With 63 offices and more than 450 independent alliance firm locations in the United States, BDO has the bench strength and coverage to serve you.

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 63 offices and over 450 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,408 offices in 154 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit www.bdo.com.

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