EUROPEAN HOLDING COMPANIES INVESTING IN GERMANY
- IN THE LIGHT OF NEW ANTI-TREATY/DIRECTIVE SHOPPING RULES -

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UK HOLDING REGIME

- Attractive tax regime, extensive treaty network
- Dividends generally exempt from tax
- Participation exemption on disposals of shares in trading subsidiaries
- No withholding tax on dividends
- No non resident CGT apart from in UK property rich companies
- Consultation on treatment of asset holding companies
LUXEMBOURG INVESTMENT PLATFORMS

- International financial centre and a prime holding location
- Flexible and diverse legal, regulatory and tax framework
- Broad range of regulated, unregulated and semi-regulated vehicles
- Experienced and pro-business regulatory authority
- Compliance with all international tax standards
- AAA Rating
LUXEMBOURG INVESTMENT PLATFORMS

- Real estate investment structure
- German PropCo
LUXEMBOURG INVESTMENT PLATFORMS

- Real estate investment structure
- Luxembourg property company

LuxMasterCo
LuxPropCo
Investors
Lux Fund

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Luxembourg as a régional investment platform of a multinational group
THE WHOLLY ARTIFICIAL ARRANGEMENT DOCTRINE

In an EU context, anti-abuse legislation provided under domestic tax law and in tax treaties has to:

- Focus on “wholly artificial arrangements” (e.g. letterbox companies)
- Require an analysis of each individual case (rather than relying on formatted criteria)
- Include a substance test (appropriate as opposed to excessive substance)
- Consider the substance of the entire group in a jurisdiction (rather than focusing only on the substance of the direct parent company)
- Consider economic activity in a broad sense (including asset management and generating exclusively foreign sourced income)
THE WHOLLY ARTIFICIAL ARRANGEMENT DOCTRINE

In an EU context, anti-abuse legislation provided under domestic tax law and in tax treaties has to:

- Disregard the motives of the taxpayer for the choice of the location of the holding company (tax jurisdiction shopping is legitimate)
- Not exclude EU parent companies that are directly or indirectly owned by shareholders resident in third states
- Allow taxpayers to provide evidence to demonstrate the appropriateness of the structure (there should not be an irrebuttable presumption of abuse or fraud)
**GERMAN ANTI-TREATY/DIRECTIVE-SHOPPING RULE**

- Generally **26.375%** WHT on German dividends are levied *regardless* of an applicable DTT or PSD (on royalties: **15.825%** WHT)

- Sec. 50d (3) Income Tax Act (ITA): WHT relief under a DTT or PSD is *only granted* to a foreign company if
  - **(a)** the foreign company’s shareholders would be entitled to the same WHT relief if they directly earned the German income (“personal relief”), *or*
  - **(b)** certain *substance requirements* are met at the level of the foreign company (*eg gross earnings of the foreign company result from its own business activity*)

- **Draft bill** of 20 January 2021 shall revise Sec. 50d (3) ITA
  - WHT relief is denied if personal relief (see above) is not met *and*
    - Income has no substantial connection with the company’s economic activity, *or*
    - Income is passed on (pass-through entity), *or*
    - Company/foundation has no appropriately established business

- **Escape** possible for stock exchange listed companies or if PPT is fulfilled
CASE 1: PERSONAL RELIEF OF SHAREHOLDERS

- GerCo pays dividend to LuxCo
  - (gross amount EUR 10m ➔ WHT: EUR 2.6m)

- LuxCo is generally entitled to
  - a) WHT reduction to 5% (Art. 10 (2) a) DTT-Lux) and
  - b) WHT reduction to 0% (PSD)

Assumptions:
- USCo is entitled to WHT reduction to 0% (Art. 10 (3) DTT-US)
- LuxCo does not fulfil substance requirements

Is “personal relief” of USCo under DTT-US sufficient for refund of German WHT?
CASE 1A: PERSONAL RELIEF OF SHAREHOLDERS

- GerCo pays dividend to LuxCo (EUR 10m)
  - WHT: EUR 2.6m

- UKCo is entitled to WHT reduction to 5%
  (Art. 10 (2) lit. a DTT-UK)

- LuxCo does not fulfil substance requirements

→ Is refund of EUR 1.1m (= difference to reduced tax rate) available?
CASE 2: MATERIAL RELIEF ("SUBSTANCE")

- GerCo pays dividend to LuxCo (EUR 10m)
  - WHT: EUR 2.6m

- UKCo is entitled to WHT reduction to 5% (Art. 10 (2) lit. a DTT-UK), LuxCo would be entitled to 0% under PSD

- LuxCo is a mere (passive) holding company
  - No operational business, but LuxCo exercises its rights as shareholder
  - LuxCo employs qualified personnel capable of managing day-to-day activities
  - LuxCo rents business premises, technical means of communication, etc.

Alt. 1: LuxCo reinvests the dividend
Alt. 2: LuxCo immediately forwards the dividend to UKCo

➔ Is refund of German WHT possible?
CASE 2A: MATERIAL RELIEF ("SUBSTANCE")

- GerCo pays dividend to LuxCo (EUR 10m)
  - WHT: EUR 2.6m

- UKCo is entitled to WHT reduction to 5%
  (Art. 10 (2) lit. a DTT-UK), LuxCo would be entitled to 0% under PSD

- LuxCo is an active holding company
  - LuxCo has controlling effect on the business of its subsidiaries
  - LuxCo provides group services to its subsidiaries, e.g. management activities
  - LuxCo employs qualified personnel capable of managing day-to-day activities, rents business premises, technical means of communication, etc.

→ Is refund of German WHT possible?
CASE 3: MATERIAL RELIEF ("SUBSTANCE")

- GerCo pays dividend to UKCo (EUR 10m)
  - WHT: **EUR 2.6m**

- UKCo is entitled to WHT reduction to **5%**
  (Art. 10 (2) lit. a DTT-UK)

- UKCo has an operational business

Alt. 1: GerCo sells goods produced by UKCo (or vice versa) → supply/service relationships

Alt. 2: The business areas of UKCo and GerCo are fundamentally different

→ Is partial refund of German WHT possible?
NEW PRINCIPAL PURPOSE TEST

- Sec. 50d (3) ITA shall **not apply** to the extent that the ForeignCo proves that **none of the main purposes** of its involvement is to obtain a **tax advantage**.
  - Proof of reasons for ForeignCo’s interposition
  - All tax and non-tax reasons are taken into account, including those arising from group structures
  - Appreciation of “all circumstances of the individual case”
  - What were “main purposes”? Foreign or German tax advantages?
CONCLUSION

- Draft law apparently adapts EU case law (counter-evidence possible)

- Many uncertainties – even more than before!

- Adaption of ECJ’s wholly artificial arrangement doctrine depends on the application of the new law by German tax authorities
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