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German Tax and Legal News

New tax treaty with Netherlands applies as from 1 January 2016

New real estate clause will affect inbound investors

Germany and the Netherlands signed a new tax treaty on 12 April 2012 to replace the existing treaty dating from 1959. The instruments of ratification between both countries were exchanged in October 2015, with the treaty entering into force on 1 December 2015. After more than three years from the date the treaty was signed, the new provisions will apply as from 1 January 2016.

One of the most notable features of the new treaty is a real estate clause in the capital gains article that will affect German inbound real estate investors. Under the new treaty, capital gains derived from the alienation of shares in a real estate company may be taxed in the state in which the property is located rather than the state in which the seller is resident. According to capital gains provision (article 13(4)) in the OECD model treaty, a real estate company is a company that derives more than 50% of its value, directly or indirectly, from immovable property.

The new provision will impact German inbound real estate investors that have structured their investment in such a way that a Dutch holding company holds shares in a German GmbH that, in turn, holds real estate located in Germany. Capital gains from the sale of shares in the German GmbH currently are not taxable in Germany and they often fall within the scope of the Dutch participation exemption. As from 2016, 5% or even 100% (i.e. in the case of a short-term share trading) of such gains may be subject to corporate income tax in Germany.

Capital gains from the sale of shares in Dutch corporations that directly hold German real estate are not affected by the new provisions if the Dutch corporation does not have its place of management and control in Germany (since Germany only has the right to tax gains under domestic law if a foreign corporation whose legal seat is outside Germany is managed and controlled in Germany).

The real estate clause in the Netherlands treaty differs significantly from the OECD model and from any other German treaty. The clause provides as follows:

- The clause applies if the (real estate) company derives more than 75% of its value, directly or indirectly, from immovable property.
- When determining the 75% requirement, immovable assets on which the real estate-owning company or its shareholders carry on their business will be ignored.
- In the German language version (but not the Dutch version) of the new treaty, the real estate clause lacks the usual reference to the location of the immovable property. The right to tax capital gains, subject to other requirements, is shifted only because a company derives more than 75% of its value from immovable property. The location of the property in the company's country of residence is irrelevant. As a result, the sale of shares in a German GmbH by a Dutch shareholder may be taxed in Germany even if the property is situated in the Netherlands or in a third country. It currently is unclear whether this mistake in the German version will be corrected.
- The real estate clause applies only if the seller holds at least 50% of the shares in the real estate company before the first share disposal.
- The new treaty makes use of the exceptions mentioned in section 28.7 seqq. of the OECD commentary on article 13, so that the right to tax remains with the state in which the seller is resident in the case of the sale of shares of companies listed on an approved stock exchange or as part of a corporate reorganization.

Other notable features of the treaty are as follows:

- The default rate of 15% on dividends remains unchanged, but a 5% withholding tax rate (reduced from 10%) will apply to dividends paid to a company (other than a partnership) that holds directly at least 10% of the capital of the payer company, and a new maximum rate of 10% will apply if the beneficial owner is a Dutch-resident pension fund.

- No change is made to the tax treatment of interest or royalties, i.e. such payments will remain exempt from withholding tax.

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