GERMANY

OUTLINE

LIST OF ABBREVIATIONS

Agreement	Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments
CITL	Corporate Income Tax Law (*Körperschaftsteuergesetz*)
Directive	Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States
ECJ	European Court of Justice
GTC	General Tax Code (*Abgabenordnung*)
ITL	Income Tax Law (*Einkommensteuergesetz*)
Merger Directive	Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States
l.c.	in the place cited (*loco citato*)
MBTL	Municipal Business Tax Law (*Gewerbesteuergesetz*)
OECD	Organization for Economic Cooperation and Development
OECD MC	OECD Model Tax Convention 2003
PE	Permanent establishment
Parent-Subsidiary Directive	Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
PE Guidelines	Administrative Principles for the examination of the income allocation in respect of permanent establishments of internationally related enterprises

LIST OF LEGAL REFERENCES

Laws

- Corporate Income Tax Law: *Körperschaftsteuergesetz*, version dated 15 October 2002, published in the Federal Law Gazette (*Bundesgesetzblatt*) 2002, part I, at 4144, last amended 15 December 2004, Federal Law Gazette 2004, part I, at 3416.

- Foreign Tax Law: *Außensteuergesetz* of 8 September 1972, published in the Federal Law Gazette (Bundesgesetzblatt) 1972, part I, at 1713, last amended 9 December 2004, Federal Law Gazette 2004, part I, at 3310.

- Income Tax Law: *Einkommensteuergesetz*, version dated 19 October 2002, published in the Federal Law Gazette (Bundesgesetzblatt) 2002, part I, at 4210 and 2003, part I, at 179, last amended 15 December 2004, Federal Law Gazette 2004, part II, at 1653.

- EU Administrative Assistance Adjustment Law (*EG-Amtshilfe-Anpassungsgesetz)* of 2 December 2004 (published in the Federal Law Gazette (*Bundesgesetzblatt*) 2004, part I, at 3112 et seqq.).

- General Tax Code: *Abgabenordnung*, version dated 1 October 2002, published in the Federal Law Gazette (*Bundesgesetzblatt*) 2002, part I, at 3866 and Federal Law Gazette 2003, part I, at 61, last amended 9 December 2004, Federal Law Gazette 2004, part I, at 3310.

- Municipal Business Tax Law: *Gewerbesteuergesetz*, version dated 15 October 2002, published in the Federal Law Gazette (*Bundesgesetzblatt*) 2002, part I, at 4167, last amended 15 December 2004, Federal Law Gazette 2004, part II, at 1653.

  The texts of the several drafts, amendments etc. with explanations can be found on the website of the Lower House of the Federal Parliament (*Bundestag*) under http://dip.bundestag.de/gesta/15/D070.pdf. The majority of the new provisions is contained and explained in the Lower House of the Federal Parliament printed matter (*Bundestags-Drucksache*) 15/3679 of 6 September 2004.

Administrative Guidelines

- Administrative Principles for the examination of the income allocation in respect of permanent establishments of internationally related enterprises (*Grundsätze der Verwaltung für die Prüfung der Aufteilung der Einkünfte bei Betriebsstätten international tätiger Unternehmen*), Decree of 24 December 1999, published in the Federal Tax Gazette (*Bundessteuerblatt*) 1999, part I, at 1076 et seqq.

- Federal Ministry of Finance letter dated 26 April 2004 (IV B 4 - S 1316 - 8/04) on the application of the provisions of the Directive until the entry into force of the German law implementing the Directive, published in the Federal Tax Gazette 2004 (*Bundessteuerblatt*), part I, at 479.

- Federal Ministry of Finance letter of 16 August 2004 (IV B 8 - S 1316 - 39/04) on the application of the provisions of the Directive to the 10 Accession States until the entry into force of the German law implementing the Directive, published in the Federal Tax Gazette 2004 (*Bundessteuerblatt*), part I, at 851.

- Federal Ministry of Finance letter of 28 June 2005 (IV B 1 - S 1316 - 42/05) on the application of the relief to be granted under Art. 15 of the Agreement in respect of Swiss companies, published in the Federal Tax Gazette 2005 (*Bundessteuerblatt*), part I, at 858.

- Regional Finance Office of Munich (*Oberfinanzdirektion München*), Regulation (*Verfügung*) of 28 May 1998, published in: *Der Betrieb* 1998, at 1307.

Case Law

- Federal Tax Court (*Bundesfinanzhof*) decision of 30 August 1995, case No. I R 112/94, published in the Federal Tax Gazette (*Bundessteuerblatt*) 1996, part II, at 563.

- Federal Tax Court (*Bundesfinanzhof*) decision of 31 May 2005, case No. I R 74, 88/04, not (yet) published in the Federal Tax Gazette.

Articles

- Dautzenberg, Norbert: "Europäische Agenda für das Ertragsteuerrecht im Jahr 2004: Die Richtlinien vom Juni 2003", published in: Betriebs-Berater 2004, at 17.

- Dörr, Ingmar: "Praxisfragen zur Umsetzung der Zins- und Lizenzrichtlinie in §50g EStG", published in: Internationales Steuerrecht 2005, at 109.

- Kessler, Wolfgang, Eicker, Klaus, Schindler, Jörg: "Hinzurechnung von Dauerschuldzinsen nach § 8 Nr. 1 GewStG verstößt gegen die Zins- /Lizenzgebühren-Richtlinie", published in: Internationales Steuerrecht 2004, at 678.

PART I. IMPLEMENTATION OF THE DIRECTIVE

1. INTRODUCTION

1.1. GENERAL INFORMATION ON THE IMPLEMENTATION OF THE DIRECTIVE

Germany has implemented Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States, as amended by Directives 2004/66/EC of 26 April 2004 and Directive 2004/76/EC of 29 April 2004 (the “Directive”) by the *EG-Amtshilfe-Anpassungsgesetz* (EU Administrative Assistance Adjustment Law) of 2 December 2004. The parliamentary proceedings concerning the implementation of the Directive can be found on the website of the Lower House of the Federal Parliament (*Bundestag*). The relevant new provisions were included in the Income Tax Law (ITL) and in the Corporate Income Tax Law (CITL). The provisions implementing the Directive generally apply retroactively to qualifying interest and royalties paid after 31 December 2003, and in respect of the 10 Accession States, to qualifying interest and royalties paid after 30 April 2004.

Prior to implementing the Directive (as amended), the German Ministry of Finance, in a letter dated 26 April 2004, instructed the German tax authorities on the application of the provisions of the Directive until the entry into force of the German law implementing the Directive. The tax authorities generally were to retroactively apply the provisions of the Directive to qualifying interest and royalty payments made on or after 1 January 2004. By letter of 16 August 2004, the Ministry instructed the tax authorities to accordingly apply the letter of 26 April 2004 to the 10 Accession States in respect of qualifying interest and royalty payments made after 30 April 2004.

The table below depicts the relevant provisions that were included in the Income Tax Law and in the Corporate Income Tax Law in order to implement the Directive.

Articles of the Directive	Relevant sections of national laws
Art. 1(1)	Sec. 50g(1) of the ITL
Art. 1(2)	Sec. 50g(1) of the ITL
Art. 1(3)	Sec. 50g(3), No. 2 of the ITL
Art. 1(4)	Sec. 50g(3), No. 1.a) of the ITL
Art. 1(5)	Sec. 50g(3), No. 1.b) of the ITL
Art. 1(6)	Sec. 50g(3), No. 3 of the ITL
Art. 1(7)	Sec. 50g(1), 3rd sentence of the ITL
Art. 1(8)	Sec. 50g(1), 4th sentence of the ITL
Art. 1(9)	Sec. 50g(1), 4th sentence of the ITL
Art. 1(10)	---
Art. 1(11)	Sec. 50d(4) of the ITL

Articles of the Directive	Relevant sections of national laws
Art. 1(12)	Sec. 50d(2) of the ITL
Art. 1(13)	Sec. 50d(2), 1st sentence of the ITL
Art. 1(14)	Sec. 50d(2), 4th sentence of the ITL
Art. 1(15)	Sec. 50d(1) of the ITL
Art. 1(16)	Sec. 50d(1), (1a) of the ITL;
Art. 2(a)	Sec. 50g(3), No. 4.a) of the ITL
Art. 2(b)	Sec. 50g(3), No. 4.b) of the ITL
Art. 3(a)	Sec. 50g(3), No. 5.a) of the ITL, in conjunction with Annex 3, 3a to the ITL
Art. 3(b)	Sec. 50g(3), No. 5.b) of the ITL
Art. 3(c)	Art. 3c): Sec. 50g(3), No. 5.c) of the ITL
Art. 4(1)	Sec. 50g(2), No. 1 of the ITL
Art. 4(2)	Sec. 50g(2), No. 2 of the ITL
Art.5	Sec. 50g(4) of the ITL
Art. 6	Art. 6(2), (3): Sec. 26(6), sentences 3-8 of the CITL
Art.7	Secs. 50d, 50g, 50h, 52(59a), (59b) of the ITL

1.2. TAX TREATMENT OF INTEREST AND ROYALTY PAYMENTS UNDER GENERAL TAX LAW

1.2.1. Domestic rules

a. Tax treatment at the level of the paying company

Deduction of interest and royalty payments

Interest and royalties payments generally constitute deductible expenses.

Municipal Business Tax

An exception applies to interest payments that are subject to municipal business tax at the level of the paying company according to Secs. 7, 8 No. 1 of the Municipal Business Tax Law (MBTL). According to Sec. 8 No. 1 of the MBTL, 50% of interest on "permanent debts", i.e. debts relating to the foundation, acquisition, expansion or improvement of the business and debts with a term of at least 1 year have to be added back to the municipal business tax base, i.e. are subject to municipal business tax. The taxable base of the municipal business tax is subject to a federal basic rate of 5% (*Messzahl*) and then to a municipal coefficient (*Hebesatz*), which generally varies from 300% to 490%, depending on the municipality (the minimum coefficient is 200%).

Whilst interest payments are usually fully deductible for corporate income tax purposes (see exceptions below), this add-back leads to the non-deductibility of the payments specified above for municipal business tax purposes.
Some German tax scholars hold that the add-back under Sec. 8 No. 1 of the MBTL at the level of the company paying the interest is contrary to the Directive (see Dautzenberg, BB 2004, at 17, 19; Kessler/Eicker/Schindler, IStR 2004, at 678 et seqq; Dörr, IStR 2005, at 109, 110, footnote 16)).

Thin capitalisation rules

An exception applies to interest payments falling within the scope of the German thin capitalization rules as laid down in Sec. 8a of the CITL. Interest paid on long-term loans by resident companies to their resident or non-resident shareholders holding a substantial interest (i.e. more than 25% of the nominal capital of the company) is treated as a hidden profit distribution if the interest is paid on excessive debt financing. In that case, the interest is reclassified as a dividend, with the result that the payment no longer constitutes a deductible expense.

Hidden profit distributions

Sec. 8(3), 2nd sentence of the CITL provides that "hidden profit distributions (*verdeckte Gewinnausschüttung*) shall not reduce the income of a corporation". There are four requirements for the assumption of a hidden profit distribution, all of which must be met:

- the assets of the corporation were reduced or the increase of the company's assets was prevented;
- this was caused by the corporation-shareholder relationship (this is the case if a third party (a non-shareholder) - by applying sound business principles - would not have agreed to the conditions of the transaction if he had dealt with the company);
- this decrease or prevented increase reduced the income of the corporation; and
- this decrease or prevented increase was not based on a regular profit distribution resolution under company law.

Excessive interest and royalty payments to shareholders or their affiliates (i.e. to the extent that the interest rate charged exceeds the market rate for a similar loan or the royalty charged exceeds the market price for a similar agreement) are treated as non-deductible hidden profit distributions (i.e. the tax base of the distributing company is increased by the value of the benefit, which triggers an additional corporation tax of 25% on the benefit (increased to 26.38% by the 5.5% solidarity surcharge).

Hidden capital contributions

The rules governing hidden capital contributions (*verdeckte Einlage*) are found in Sec. 4(1) of the ITL in conjunction with Sec. 8(1) of the CITL. A hidden capital contribution can be assumed if a shareholder or a related party of the shareholder makes a contribution to the corporation without proper consideration and the reason for this contribution can only be found in the shareholder relationship. This is the case if a third party (a non-shareholder) - by applying sound business principles - would not have agreed to the conditions of the transaction if he had dealt with the company.

In the case of a hidden capital contribution, the income of the parties to the transaction must be adjusted accordingly, that is, on the side of the parent company the book value (acquisition costs adjusted by subsequent write-downs or additions) of the German parent's holding in the subsidiary is increased by an addition to this particular balance sheet entry. The amount of this increase corresponds to the income adjustment. The resulting increase in the shareholder's equity automatically results in correspondingly higher taxable income.

Transfer pricing rules

According to Sec. 1 of the Foreign Tax Code (*Außensteuergesetz*), a taxpayer's income will be increased if such income was diminished in the course of his business relations with a related party abroad, if he agreed to terms and conditions that deviate from those with unrelated parties, agreed upon under the same or similar circumstances. In such a case the income should be increased to a level that commensurates with third-party conditions.

It should be noted that the income adjustment under Sec. 1 of the Foreign Tax Code only applies if the income does not have to be adjusted under another provision (i.e. the rules governing hidden profit distributions and hidden capital contributions prevail).

b. Tax treatment at the level of the beneficiary company

Interest

German-resident recipients are generally subject to German tax on domestic as well as foreign-source interest received.

A withholding tax on interest payments by German-resident payers (or non-resident payers, if paid through a German PE) to German-resident recipients is imposed on interest from convertible bonds, profit-sharing bonds, participation loans, as well as income from the participation of silent partners in a trade or business. The rate is 25% (26.38% including the 5.5% solidarity surcharge). Furthermore, a withholding tax is inter alia imposed on interest paid by banks and on interest paid on certain bonds. The rate is 30% (31.65% including the surcharge). Anonymous over-the-counter banking is subject to a 35% rate (36.93% including the surcharge).These withholding taxes are creditable against the final corporate income tax liability of the recipient resident company.

In the case of a **non-resident recipient**, if the interest payments are attributable to a German permanent establishment of the non-resident, the interest is part of the business profits and assessed based on the basis of a tax return.

Otherwise, interest payments to non-resident companies are subject to German tax if:
- the loan is secured directly or indirectly by a mortgage on German immovable property or on a ship registered in a German ship register (Sec. 49(1) No. 5c of the ITL).
- the interest is paid on convertible bonds (Sec. 49(1), No. 5a of the ITL).
- the interest is paid on jouissance rights, profit-sharing bonds, participation loans, as well as income from the participation of typical silent partners in a trade or business (Sec. 49(1) No. 5a of the ITL).
- the interest is paid on coupons from bearer bonds and is not credited to an account of a foreign bank (anonymous over-the-counter transactions) (Sec. 49(1) No. 5c of the ITL).

In the PE case, as well as in the first case mentioned thereafter, corporate income tax is assessed at a rate of 25%, increased to 26.38% by the 5.5% solidarity surcharge. In the other cases, interest is subject to withholding tax at source. In the second and third cases, withholding tax is generally levied at the rate of 25% (26.38% including the 5.5% solidarity surcharge). In the fourth case, a withholding tax of 35% (36.93% including the surcharge) is levied.

The withholding tax levied on interest payments to non-resident recipients is generally final.

Royalties

German-resident recipients are generally subject to German tax on domestic as well as foreign-source royalties received.

There is no withholding tax on royalties paid **to German-resident recipients**.

Royalties paid **to non-resident recipients** are generally subject to German source taxation if the underlying right is registered in a German register (e.g. the patent or trademark register) or if the right belongs to a German business (Sec. 49(1), Nos. 6 and 9 of the ITL). Royalties paid to non-residents are subject to corporate income tax, which is imposed by withholding at the rate of 20%, Sec. 50a(4) of the ITL (21.1% including the 5.5% solidarity surcharge). The withholding tax levied on royalty payments to non-resident recipients is generally final. If the royalties are attributable to a German permanent establishment of the non-resident, however, they form part of the non-resident's business income, and are taxed by assessment.

Thin capitalisation rules

At the level of the shareholder receiving the excessive interest payment, the excess constitutes a hidden profit distribution. The hidden profit distribution is treated in the same way as a dividend distribution, i.e. withholding tax is levied at the rate of 20% (increased to 21.1% by the 5.5% solidarity surcharge). However, the foreign shareholder may receive a refund if he is entitled to a lower treaty rate on dividends, or if the company is located in the European Union and meets the criteria of the EU Parent-Subsidiary Directive.

Hidden profit distributions

At the level of the shareholder receiving the benefit, the value of the benefit constitutes a hidden profit distribution. The hidden profit distribution is treated in the same way as a dividend distribution, i.e. withholding tax is levied at the rate of 20% (increased to 21.1% by the 5.5% solidarity surcharge). However, the foreign shareholder may receive a refund if he is entitled to a lower treaty rate on dividends, or if the company is located in the European Union and meets the criteria of the EU Parent-Subsidiary Directive.

Hidden capital contribution

In the case of a hidden capital contribution, the income of the parties to the transaction must be adjusted accordingly, that is, the income must be reduced on the recipient's side.

Transfer pricing rules

If the profit shift abroad comes exclusively within Sec. 1 of the Foreign Tax Code, an addition to the taxpayer's income is made outside the balance sheet.

1.2.2. Treaties

The income tax treaties concluded between Germany and other EU Member States (see Annex) usually include provisions on the avoidance of double taxation in respect of cross-border interest and royalty payments.

a. Interest

Under the majority of Germany's tax treaties with other EU Member States, interest payments from Germany to other EU Member States are taxable only in the recipient's State of residence. If Germany has retained the right to levy a withholding tax, the maximum rates under the treaties range between 5% and 15%. In many tax treaties concluded with EU Member States, Germany has retained the right to levy a withholding tax (either at the domestic rate or at a reduced rate of 10% or 15%) in respect of payments on profit-sharing bonds and participating loans.

b. Royalties

Under many of Germany's tax treaties with other EU Member States, royalty payments from Germany to other EU Member States are taxable only in the recipient's State of residence. If Germany has retained the right to levy a withholding tax, the maximum rates under the treaties range between 5% and 10%.

2. SCOPE

2.1. PAYMENTS

2.1.1. Concept of interest

a. Definition

Under Sec. 50g(3), No. 4a of the ITL, the German provision implementing Art. 2a) of the Directive, the term "interest" is defined as income from debt-claims of every kind, whether or not secured by mortgage, and in particular, income from securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures; penalty charges for late payment and repayments of capital are not regarded as interest.

Thus, the definition under Sec. 50g of the ITL appears narrower than the definition under the Directive in that the former definition does not include income from debt-claims carrying a right to participate in the debtor's profits, whilst the definition under the Directive does. However, this deviation does not seem to fail to comply with the provisions of the Directive, since Art. 4(1)(b) of the Directive explicitly allows the source State to exclude such payments from the benefits of the Directive.

Furthermore, the definition under Sec. 50g of the ITL appears narrower than the definition under the Directive in that the former definition explicitly states that repayments of capital are not regarded as interest, whilst the definition under the Directive does not. Again, however, this deviation does not seem to fail to comply with the provisions of the Directive, since Art. 4(1)(a) of the Directive explicitly allows the source State to exclude such payments from the benefits of the Directive.

b. Exclusion of hybrid financial arrangements (Art. 4(1) b)-d))

As explained under question 2.1.1.a. above, Germany has excluded payments from debt-claims carrying a right to participate in the debtor's profits from the benefits of the Directive by not including these payments within the definition of the term "interest" under the Sec. 50g(3), No. 4a of the ITL.

Furthermore, Sec. 50g(2), No. 1b of the ITL explicitly states that interest payments from debt-claims carrying a right to participate in the debtor's profits do not qualify for the exemption. According to the Federal government's explanations in the Bill implementing the Directive (see *Bundestags-Drucksache* (Lower House of the Federal Parliament, printed matter) 15/3679 of 6 September 2004, at 20), this provision covers profit-sharing bonds, participating loans, income from the participation in a trade or business as a silent partner and income from jouissance rights. Furthermore, payments that provide for a fluctuating interest rate (depending on the debtor's profits) instead of a fixed interest rate are excluded (payments where the interest rate depends on the debtor's turnover, however, are not excluded). Finally, the Federal government's explanations state that income from convertible bonds is excluded from the benefits of the Directive under this provision.

Germany did not use the options under Art. 4(1)(c) and (d) of the Directive.

c. Exclusion of interest reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

Art. 4(1)(a) of the Directive

As already mentioned under question 2.1.1.a. above, Germany has excluded payments treated as a repayment of capital from the benefits of the Directive by excluding these payments from the definition of the term "interest" under the Sec. 50g(3), No. 4a of the ITL.

Furthermore, Sec. 50g(2), No. 1a of the ITL states that interest payments that are treated as a distribution of profits under German law (the provision makes reference to Sec. 20(1), No. 1, 2nd sentence of the ITL, which classifies hidden profit distributions as income from shares) do not qualify for the exemption from German tax. For the concept of hidden profit distributions under German law, see question 1.2.1. above.

Interest payments reclassified as a profit distribution under Sec. 8(3), 2nd sentence of the CITL (hidden profit distribution) or Sec. 8a of the CITL (thin capitalization) may fall within the scope of Sec. 43b of the ITL, the provision implementing the Parent-Subsidiary Directive.

Art. 4(2) of the Directive

According to Sec. 50g(2), No. 2 of the ITL, interest payments exceeding the arm's length amount do not qualify for the exemption from tax. The provision refers to a special relationship existing due to the payer and the beneficial owner, or some other person, being associated companies as defined by the Directive.

From the wording of the provision, it does not seem entirely clear which amount is meant (i.e. the entire amount or only the amount exceeding the arm's-length amount). According to the Federal government's explanations in the Bill implementing the Directive (see *Bundestags-Drucksache* (Lower House of the Federal Parliament, printed matter) 15/3679 of 6 September 2004, at 21), the tax exemption would only be disallowed to the extent that the interest payment exceeds the arm's-length amount.

The Federal government, according to its explanations in the Bill implementing the Directive (see *Bundestags-Drucksache* (Lower House of the Federal Parliament, printed matter) 15/3679 of 6 September 2004, at 21), views the provision as an adoption of the principles laid down in Art. 11(6) of the OECD MC. German domestic law includes the following provisions on the adjustment of non arm's-length payments between related entities:

- the hidden profit distribution (see question 1.2.1. above), which is already covered by the option under Art. 4(1)(a) of the Directive;
- the hidden capital contribution; see question 1.2.1. above; and
- the adjustment of inappropriate transfer prices under Sec. 1 of the Foreign Tax Law (*Außensteuergesetz*); see question 1.2.1. above.

2.1.2. Concept of royalties

a. Definition

Under Sec. 50g(3), No. 4b of the ITL, the German provision implementing Art. 2b) of the Directive, the term "royalties" is defined as payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films and software, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; payments for the use of, or the right to use, industrial, commercial or scientific equipment shall be regarded as royalties. The definition under German law exactly corresponds to the German-language text of the Directive.

b. Classification of revenue from leasing and software

A non-resident company is only subject to limited German corporate income tax liability if its German-source income falls within the scope of one or more of the categories of income listed in Sec. 49 of the ITL (Sec. 2(1), No. 1 of the ITL and Sec. 8(1) of the CITL in conjunction with Sec. 49 of the ITL). Payments received by a non-resident company in consideration for the use of, or the right to use, software, and payments for the use of, or the right to use, industrial, commercial or scientific equipment (payments from leasing) may fall within the scope of the following categories:

- Business income attributable to a German permanent establishment or to a German permanent agent of the non-resident (Sec. 49(1), No. 2a of the ITL).
- Business income derived from the alienation of immovable property, certain movable property and rights, as defined in Sec. 49(1), No. 6 of the ITL (see below; Sec. 49(1), No. 2f of the ITL).
- Income from independent personal services rendered or exploited in Germany, or attributable to a German fixed base or permanent establishment of the non-resident (Sec. 49(1), No. 3 of the ITL).
- Income from rent and leasing, if the immovable property, the inventories or rights are situated in Germany or are recorded in a domestic public register (e.g. the patent or trademark register), or if they are exploited in a German permanent establishment or in another facility (Sec. 49(1), No. 6 of the ITL).
- Income from the use of movable assets in Germany, or from the letting of the use, or the right to use, of commercial, technical, scientific and similar experiences, know-how and skills (e.g. plans, samples and processes), which are, or have been, used in Germany (Sec. 49(1), No. 9 of the ITL).

If business income is attributable to a German permanent establishment of the non-resident, the income is generally taxed by assessment. In the other cases, tax is levied by withholding at the rate of 21.1% (see question 1.2.1. above).

In respect of payments from the use of, or the right to use, software, the principles outlined below generally apply in Germany.

There is no legal definition of the term "software". Generally, the term covers the programmes, which are necessary for the running of the computer system. In respect of user software (i.e. the software necessary to carry out the tasks required by the user), a differentiation is made between standard software (e.g. internet browsers, e-mail programmes, videogames etc.) and individual software (i.e. software specifically programmed according to the needs of a client, who ordered the software, or which can be individually adapted to the needs of a specific client).

The distribution of <u>standard software</u> for the permanent use of the buyer (online or by physical trade) generally is not regarded as a transfer of the use, or of the right to use, the software, in the sense of Sec. 49(1), Nos. 6, 9 of the ITL (see above), but as an alienation. Consequently, in the absence of a German permanent establishment, the income is not subject to limited German tax liability (*OFD München* (Regional Finance Office of Munich), regulation of 28 May 1998). If the standard software, however, is not transferred for the permanent use of the buyer, but only for a limited amount of time, the transfer of the use, or of the right to use, the standard software may fall within the scope of Sec. 49(1), No. 9 of the ITL.

The distribution of <u>individual software</u> for the permanent use of the buyer (online or by physical trade) is generally regarded as the alienation of a right falling within the scope of Sec. 49(1), No. 2f of the ITL (see above). If, however, the software is not transferred for permanent use, but only for a limited amount of time, the payments may fall within the scope of Sec. 49(1), No. 6 of the ITL (see above), provided that the software is exploited in a German permanent establishment or in another facility.

In general, a differentiation is made between the concept of royalties and the alienation of rights or assets. If a contract provides for an obligation to make successive payments for the final transfer of a right, the payments are not classified as royalties. Likewise, if in a license agreement on the use of a certain asset the elements of a sales contract prevail (e.g. if the contract provides for the transfer of ownership under retention of title (*Eigentumsvorbehalt*)), the payments are not classified as royalties.

c. Exclusion of royalties reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

<u>Art. 4(1)(a) of the Directive</u>

Germany did not make use of the option under Art. 4(1)(a) of the Directive in respect of royalty payments.

<u>Art. 4(2) of the Directive</u>

According to Sec. 50g(2), No. 2 of the ITL, royalty payments exceeding the amount that the payer and the beneficial owner would have agreed in the absence of a special relationship between them, or between one of them and some other person, do not qualify for the exemption from tax. The provision refers to a special relationship existing between the payer and the beneficial owner, or some other person, being associated companies as defined by the Directive.

The principles described under 2.1.1.c. above apply accordingly in the case of such royalty payments.

2.2. COMPANIES

2.2.1. Types of companies benefiting from implementing provisions (Art. 3(a)(i))

a. Other types of entities

According to Sec. 50g(1) of the ITL, the exemption from German (withholding) tax applies to interest and royalty payments made by an enterprise of the Federal Republic of Germany ("*Unternehmen der Bundesrepublik Deutschland*"). The term "enterprise of the Federal Republic of Germany" is not explicitly defined in the implementing provisions. It seems, however, likely that an enterprise has to fulfil the legal form, residence, and subject-to-tax requirements, in line with the definition of the term "enterprise of an EU Member State" in Sec. 50g(3), No. 5a) of the ITL.

According to Sec. 50g(3), No. 5a) aa) of the ITL, the German provision implementing Art. 3(a)(i) of the Directive, the term "business enterprise of an EU Member State" is defined as any business enterprise, which, in addition to the other requirements (residence requirement, subject-to-tax requirement), has one of the legal forms listed in Annex 3, No. 1 to the ITL (in respect of payments made after 31 December 2003 and before 1 May 2004) and Annex 3a, No. 1 to the ITL (in respect of payments made after 30 April 2004). The Annexes 3, 3a of the ITL correspond to the Annex to the Directive (as amended).

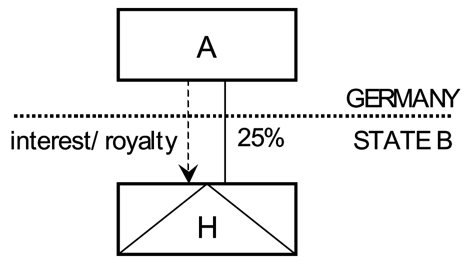
b. Payments to or from hybrid entities

There is no specific guidance with respect to the availability of an exemption from withholding tax when interest or royalties are paid to or from hybrid entities. Conclusions on the tax treatment of such payments are tentatively drawn on the basis of the general implementing provisions of the ITL. The issue of the tax treatment of payments in situations involving hybrid entities is considered based on three hypothetical situations described below:

- Case 1: a German associated company pays interest and royalties to a hybrid entity H located in Member State B;
- Case 2: a German hybrid entity H pays interest and royalties to an associated company in Member State A;
- Case 3: a German associated company pays interest and royalties to an associated company through a hybrid entity H, the latter two located in Member State A.

Case 1: Payment to a hybrid entity

A German associated company A pays interest and royalties to a hybrid entity H situated in Member State B. Germany treats hybrid entity H as a transparent entity.



The implementing rules to the Directive do not expressly address this issue. Sec. 50g(3), No. 5a of the ITL requires that the receiving EU associated company must fulfil the following requirements:
- have one of the legal forms listed in the Annex 3/ 3a, No. 1 to the ITL (see question 2.2.1.a. above);
- be resident in an EU Member State in accordance with the tax laws of a Member State (see question 2.2.2.a. below); and
- be subject to one of the taxes listed in the Annex 3/ 3a, No. 2 to the ITL (see question 2.2.3. below).

In addition, Sec. 50g(3), No. 5b of the ITL provides that the participation in the associated company must be direct. All these requirements must be met.

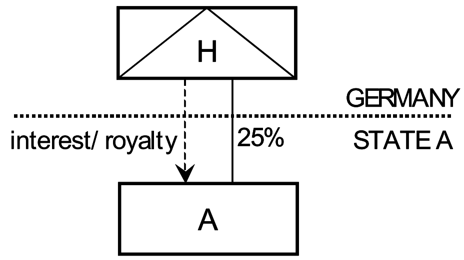
Consequently, if the foreign recipient entity meets the requirements set out above (i.e. legal form, residence, subject-to-tax), it qualifies for the benefits under the Directive. If, on the other hand, the foreign entity is a company mentioned in the Annex 3/ 3a to the ITL, but opted for taxation as a flow-through entity, so that it is not subject to one of the taxes listed in the Annex 3/ 3a to the ITL, it appears that the foreign entity would not qualify for the benefits under the Directive.

If Germany treats the hybrid entity H as transparent, it seems likely that potential corporate partners of H could qualify for the benefits under the Directive. For this situation, see case 3 below.

Finally, interest and royalty payments to a hybrid entity H, that Germany treats as transparent, could qualify for the benefits under the Directive if H could be classified as a qualifying PE of another EU-resident company.

Case 2: Payment by a hybrid entity

A hybrid entity H in Germany pays interest or royalties to an associated company A in Member State A.

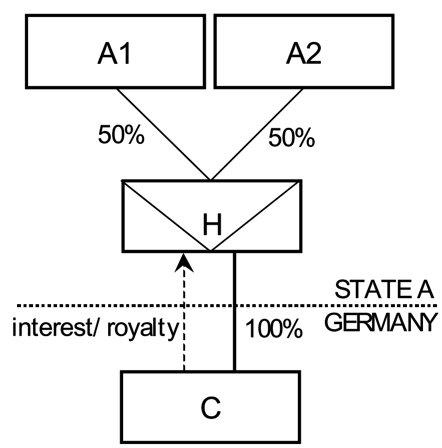


Payments by German hybrid entities (e.g. a partnership) treated as transparent in Germany do not benefit from the withholding tax exemption in Germany. Such entities are not listed as eligible companies under Sec. 50g(3), No. 5a of the ITL, in conjunction with Annex 3/ 3 a to the Directive (see question 2.2.1.*a.* above).

Even if the hybrid entity H had German-resident qualifying corporate partners (legal form, residence, subject-to-tax), it seems likely that the benefits under the Directive would be denied, since the interest or royalties are paid by the hybrid entity H.
If, however, the interest or royalties were paid by the qualifying German-resident corporate partners, it seems likely that the participation in H would be attributed to the corporate partners, so that the benefits under the Directive would apply at the level of the qualifying corporate partners.

Case 3: Payment through a hybrid entity:

Companies A1 and A2 are the members of the hybrid entity H, both located in Member State A. The hybrid entity H holds all the shares in company C, located in Germany. Company A1 grants a loan to the hybrid entity H and the hybrid entity H grants a loan to the company C. Interest flows from the company C to a member A1 through the hybrid entity H.



The implementing rules to the Directive do not expressly address this issue. If Germany treats the hybrid entity H as non-transparent, there is no direct participation in companies A1 and A2. Consequently, the withholding tax exemption is likely to be denied (only the interest/royalty payment to hybrid entity H may qualify for the benefits under the Directive, if all the requirements (legal form, residence, subject to tax) are met).

If Germany treats the hybrid entity H as transparent, the participation in C would generally be attributed to companies A1 and A2. Consequently, it seems likely that the benefits under the Directive should apply. This result would also seem to be in line with a statement in the Federal government's explanations in the Bill implementing the Directive (see Lower House of the Federal Parliament printed matter (*Bundestags-Drucksache*) 15/3679, at 20) with regard to cross-border interest and royalty payments received by a German partnership (i.e. *vice versa*). According to this statement, interest and royalty payments received by a German partnership are generally attributed to the partners of the partnership for purposes of applying the benefits under the Directive. Qualifying corporate partners (legal form, residence, subject-to-tax) accordingly should qualify for the benefits under the Directive.

2.2.2. Residence requirement (Art. 3(a)(ii))

a. Implementation of the requirement

According to Sec. 50g(3), No. 5.a) bb) of the ITL, the term "business enterprise of an EU Member State" is defined as any business enterprise, which, in addition to the other requirements (legal form, subject-to-tax requirement), in accordance with the tax laws of a Member State is resident in that Member State. According to Sec. 50g(3), No. 6 of the ITL, a business enterprise is resident in an EU Member State in the sense of Sec. 50g(3), No. 5.a) bb) of the ITL if it is subject to unlimited German tax liability, or if it is subject to a similar taxation in another EU Member State, in accordance with the laws of that Member State.

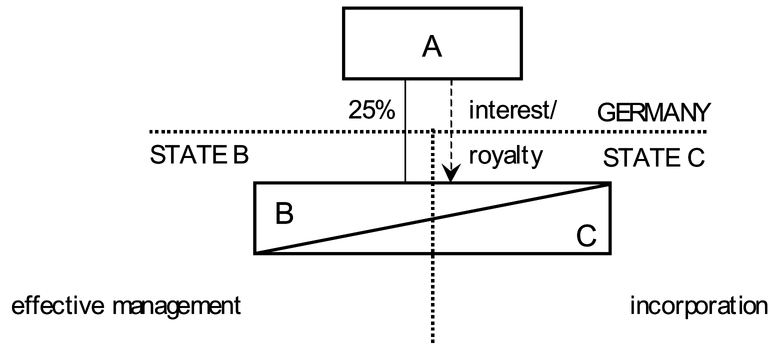
b. Application of the requirement in dual residence cases

There is no specific guidance with respect to the application of the exemption from withholding tax when interest or royalties are paid to or by dual resident companies. The tentative conclusions on the tax treatment of such payments are drawn on the basis of general implementing provisions of the ITL. The issue of tax treatment of payments in situations involving dual residency is considered based on three situations described below:

- <u>Case 1:</u> a German associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in State B;
- <u>Case 2:</u> a dual resident company BC incorporated in Member State C but with its effective management in Germany makes an interest or royalty payment to an associated company A resident in Member State A;
- <u>Case 3:</u> a dual resident company BC incorporated in Germany but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.

<u>Case 1: Payment to a dual resident</u>

A German associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in Member State B.

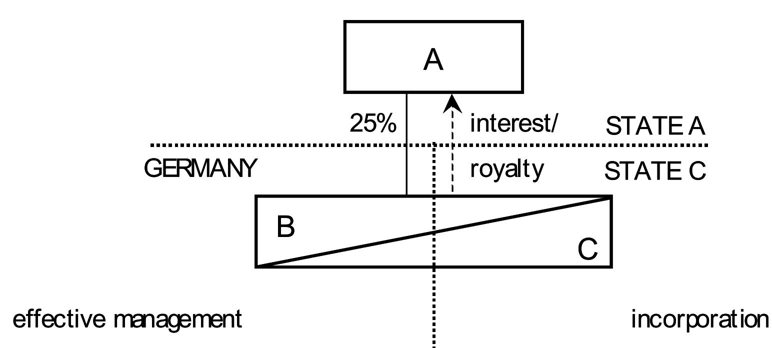


The German implementing provisions do not explicitly address the above situation. However, the explanatory notes to the German law implementing the Directive state that double residence of an enterprise within the EU does not affect the application of the benefits under the Directive (see *Bundestags-Drucksache* (Lower House of the Federal Parliament, printed matter) 15/3679 of 6 September 2004, at 21). According to Sec. 50g(3), No. 5a) bb) of the ITL, an entity resident of an EU Member State does not qualify as a "business enterprise of an EU Member State" if it is considered non EU-resident according to the income tax treaty concluded between the respective EU Member State and a non EU Member State. Consequently, entities resident in two EU Member States qualify for the application of the benefits under the Directive.

According to oral information given by the German Federal Ministry of Finance, it seems likely that the question of which Member State company BC is a resident for purposes of applying the benefits under the Directive will be decided on the basis of the income tax treaty concluded between Member States B and C. Assuming that this tax treaty follows the OECD MC, company BC will be considered resident in Member State B where its effective management is located for treaty purposes (Art. 4(3) of the OECD MC).

Case 2: Payment by a dual resident with the place of management in Germany

A dual resident company BC incorporated in Member State C but with its effective management in Germany makes an interest or royalty payment to an associated company A resident in Member State A.



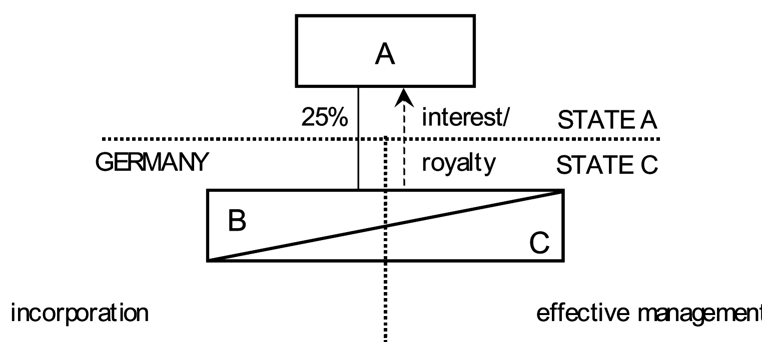
The German implementing provisions do not explicitly address the above situation. However, the explanatory notes to the German law implementing the Directive state that double residence of an enterprise within the EU does not affect the application of the benefits under the Directive (see *Bundestags-Drucksache* (Lower House of the Federal Parliament, printed matter) 15/3679 of 6 September 2004, at 21). According to Sec. 50g(3), No. 5a) bb) of the ITL, an entity resident of an EU Member State does not qualify as a "business enterprise of an EU Member State" if it is considered non EU-resident according to the income tax treaty concluded between the respective EU Member State and a non EU Member State. Consequently, entities resident in two EU Member States qualify for the application of the benefits under the Directive.

Under the German implementing provisions, the application of the benefits under the Directive is limited to payments made by German enterprises ("*Unternehmen der Bundesrepublik Deutschland*"). This term is not explicitly defined in the implementing provisions. It seems likely that an enterprise has to fulfil the legal form, residence, and subject-to-tax requirements, in line with the definition of the term "enterprise of an EU Member State" in Sec. 50g(3), No. 5a) of the ITL. The interpretation of the term for dual residence purposes, however, is not entirely clear.

However, according to oral information given by the German Federal Ministry of Finance, it seems likely that the question of which Member State a qualifying entity is a resident for purposes of applying the benefits under the Directive would be answered in accordance with the provisions of the income tax treaty concluded between Germany and the other Member State in question. The majority of the income tax treaties concluded between Germany and the other Member States contains a provision corresponding to Art. 4(3) of the OECD MC (i.e. generally the place of effective management of an entity is authoritative in the case of dual residence). Consequently, for treaty purposes, Germany would be the Member State to grant the benefits under the Directive in the case of an entity incorporated in another Member State, but with its place of effective management in Germany.

<u>Case 3: Payments by a dual resident with the place of incorporation in Germany</u>

A dual resident company BC incorporated in Germany but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.



The German implementing provisions do not explicitly address the above situation. However, the explanatory notes to the German law implementing the Directive state that double residence of an enterprise within the EU does not affect the application of the benefits under the Directive (see *Bundestags-Drucksache* (Lower House of the Federal Parliament, printed matter) 15/3679 of 6 September 2004, at 21). According to Sec. 50g(3), No. 5a) bb) of the ITL, an entity resident of an EU Member State does not qualify as a "business enterprise of an EU Member State" if it is considered non EU-resident according to the income tax treaty concluded between the respective EU Member State and a non EU Member State.

Consequently, entities resident in two EU Member States qualify for the application of the benefits under the Directive.

Under the German implementing provisions, the application of the benefits under the Directive is limited to payments made by German enterprises ("*Unternehmen der Bundesrepublik Deutschland*"). This term is not explicitly defined in the implementing provisions. It seems likely that an enterprise has to fulfil the legal form, residence, and subject-to-tax requirements, in line with the definition of the term "enterprise of an EU Member State" in Sec. 50g(3), No. 5a) of the ITL. The interpretation of the term for dual residence purposes, however, is not entirely clear.

However, according to oral information given by the German Federal Ministry of Finance, it seems likely that the question of which Member State a qualifying entity is a resident for purposes of applying the benefits under the Directive would be answered in accordance with the provisions of the income tax treaty concluded between Germany and the other Member State in question. The majority of the income tax treaties concluded between Germany and the other Member States contains a provision corresponding to Art. 4(3) of the OECD MC (i.e. generally the place of effective management of an entity is authoritative in the case of dual residence). Consequently, for treaty purposes, Germany would be the Member State to grant the benefits under the Directive in the case of an entity incorporated in another Member State, but with its place of effective management in Germany. Accordingly, in the above situation, it seems likely that the benefits under the Directive would have to be granted by Member State C, where the place of effective management of company BC is situated.
Since company BC constitutes one uniform legal entity established in the other Member State for treaty purposes, it would appear in the context of the purpose of the Directive that Germany could not tax the interest or royalty payment likewise.

2.2.3. Subject-to-tax requirement (Art. 3(a)(iii))

a. General

According to Sec. 50g(3), No. 5a) cc) of the ITL, the term "business enterprise of an EU Member State" is defined as any business enterprise, which, in addition to the other requirements (legal form requirement, residence requirement), is subject to one of the taxes listed in the Annex 3, No. 2 to the ITL (in respect of payments made after 31 December 2003 and before 1 May 2004) and the Annex 3a, No. 2 to the ITL (in respect of payments made after 30 April 2004), without being exempt from such tax. The requirement is also fulfilled if the business enterprise is subject to a tax imposed after the date of entry into force of the Directive (as amended) in place of, or in addition to, those existing taxes, provided such tax is identical or substantially similar to the taxes listed in the Annexes 3, 3a. The Annexes 3, 3a of the ITL correspond to the Annex to the Directive (as amended).

The implementing provisions do not state that the business enterprise has to be subject to tax in respect of the particular income received. Thus, it would appear that the business enterprise only has to be subject to tax in general.

However, the official form issued by the Federal Tax Office (*Bundesamt für Finanzen*), the tax authority competent for applications for refunds of withholding taxes and for an exemption from the obligation to withhold taxes in respect of payments falling within the scope of the Directive, requires the applicant to state to which tax (exact name of the tax) the payments are subject to in the country of residence of the recipient, and that the payments are not exempt from tax in the recipient's country of residence.

According to this official form, no assurance of the recipient's residence State that the payments are subject to tax is required. However, the official form for a residence certificate of the recipient's residence State (which is part of the above official form), requires the foreign tax authority to state that the taxation of the payment will be checked.

There have been no instances in Germany as a source state to refuse to accept an assurance by the residence state of the 'beneficial owner' that the latter is subject to tax in its Member State.

b. Hybrid entities

A hybrid entity only qualifies for the benefits under the Directive if it has a legal form mentioned in the Annex 3/ 3a to the ITL, if it is resident in an EU Member State according to the tax laws of that Member State, and if it is subject to one of the taxes mentioned in the Annex 3/ 3a to the ITL. According to the Directive as well as to the implementing provisions, it has to be the hybrid entity that is subject to one of the taxes mentioned; if only the owners of the entity are subject to one of the taxes mentioned, the entity accordingly would not qualify, unless the hybrid entity would be transparent, so that Germany would look through to the qualifying owners of the hybrid entity. It would thus appear that, if a hybrid entity meets all three requirements mentioned above, the application of the subject-to-tax requirement would not constitute a problem in Germany.

2.2.4. Associated company (Art. 3(b))

Almost literally implementing Art. 3(b) of the Directive into the German text, Sec. 50g(3), No. 5b of the ITL states that a company is an "associated company" of a second company if, at least

- the first company has a direct minimum holding of 25% in the capital of the second company, or
- the second company has a direct minimum holding of 25% in the capital of the first company, or
- a third company has a direct minimum holding of 25% both in the capital of the first company and in the capital of the second company.

Holdings must involve only companies resident in Community territory.

The German implementing provisions do not extend the benefits under the Directive to indirect shareholdings.

The German implementing provisions have not replaced the criterion of a minimum holding in the capital with the criterion of a minimum holding of voting rights.

There is no specific guidance concerning the application of the threshold to hybrid entities. A foreign partnership that is mentioned in the Annex 3/ 3a to the ITL, so that it qualifies for the benefits under the Directive, does not have a "capital" as referred to in Art. 3b) of the Directive. It is unclear which requirement the German tax authorities refer to in the case of such a partnership in order to determine whether or not the minimum holding requirement is met.

2.2.5. Beneficial ownership (Art. 1(4))

The German provision implementing Art. 1(4) of the Directive is Sec. 50g(3), No. 1a of the ITL. According to this provision, a company qualifies as the beneficial owner of interest or royalties if it realizes the income. The provision refers to the general principles on the realization of income on the basis of Sec. 2(1) of the ITL.

There is no legal provision explicitly regulating the attribution of income to a taxable person in general. Rather, general principles developed by the tax courts and tax scholars apply.

According to these principles, income is attributed to the taxpayer that meets the requirements of a taxable event. The requirements of a taxable event are met by producing a benefit that meets the requirements of one of the seven categories of taxable income in Germany (i.e. income from farming and forestry, business income, income from independent personal services, employment income, income from capital investment, income from rent and leasing and other income). The benefit has to be produced by a person with the - legal or factual - power of disposal about the underlying relationship (i.e. whether or not the benefit is performed, power to terminate a contract etc.). If an intermediary, such as an agent, trustee or authorised signatory, receives a payment in return for a benefit performed by a taxable person, the intermediary is not regarded as realizing the income due to a lack of power of disposal as specified above. If a taxable person wants to shift income to another person in such a way that the income is attributed to that person for tax purposes, it is not sufficient to only transfer the payments to be received in return for performing the benefit to the other person; in addition, the transfer has to include the above-mentioned power of disposal.

2.3. PERMANENT ESTABLISHMENTS

2.3.1. Definition (Art. 3(c))

In situations covered by the Directive, Germany does not apply its general concept of permanent establishment under Sec. 12 of the GTC, but implemented the permanent establishment definition provided by Art .3(c) of the Directive. Sec. 50g(3), No. 5c of the ITL defines a permanent establishment as a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on. The German text of the Directive employs the term "carry out" (*ausführen*) instead of the term "carry on" (*ausüben*) used in Sec. 50g of the ITL, but this deviation does not seem to trigger differences in interpretation.

Since the definition for situations covered by the Directive under Sec. 50g of the ITL deviates from the domestic permanent establishment definition under Sec. 12 of the GTC, the definition for purposes of applying the benefits under the Directive cannot be interpreted according to the principles developed in respect of the interpretation of Sec. 12 of the GTC. However, the definition in Sec. 50g of the ITL is similar to the definition provided by Art. 5(1) of the OECD MC. Consequently, it would appear that Sec. 50g of the ITL should be interpreted and applied in consistence with the principles developed regarding double taxation issues. Since the definition under Sec. 50g of the ITL only applies to permanent establishments being a fixed place of business, the definition does not seem to cover agency permanent establishments.

2.3.2. Application of source rules (Art. 1(2))

Germany has implemented Art. 1(2) of the Directive by granting the benefits under the Directive to interest and royalty payments <u>made by</u> a German company or a permanent establishment situated in Germany (Sec. 50g(1) of the ITL). The implementing provisions do not refer to "interest and royalty payments <u>arising</u> in a Member State".

There have been no instances become known where Germany as the source state has interpreted Sec. 50g(3), No. 5c of the ITL more narrowly than Article 5 of the OECD MC.

2.3.3. 'Tax-deductible expense' requirement (Art. 1(3))

According to Sec. 50g(3), No. 2 of the ITL, the German provision implementing Art. 1(3) of the Directive, a permanent establishment is only considered to be the debtor of interest or royalties if the payment constitutes a tax-deductible business expense for purposes of determining the profits of the permanent establishment.

There have been no instances become known where Germany or another Member State (where Germany is a state of head office or a recipient state) has refused to recognise the payment as a tax-deductible expense, because it considers that the expense is not attributable to the permanent establishment.

2.3.4. Beneficial ownership (Art. 1(5))

Section 50g(3), No. 1b of the ITL almost literally implements Art. 1(5) of the Directive into German law. According to this provision, a permanent establishment qualifies as the beneficial owner of interest or royalties if:

(i) the debt-claim, right or use of information in respect of which interest or royalty payments are made effectively belongs to the permanent establishment; and

(ii) the interest or royalty payments represent income in respect of which the profits of the permanent establishment are subject in the Member State in which it is situated to one of the taxes mentioned in Sec. 50g(3), No. 5.a) cc) of the ITL (implementing Art. 3(a)(iii) of the Directive; see question 2.2.3. above) or in the case of Belgium to the "impôt des non-résidents/belasting der niet-verblijfhouders" or in the case of Spain to the "Impuesto sobre la Renta de no Residentes" or to a tax which is identical or substantially similar and which is imposed after the date of entry into force of the Directive (as amended) in addition to, or in place of, those existing taxes.

The implementing law does not provide guidance on the application and interpretation of this provision. The explanatory notes to the implementing law merely state that the term "beneficial owner" is not known in domestic German tax law, so that it is separately defined, taking over the fictions provided by Art. 1(5) of the Directive (see *Bundestags-Drucksache* (Lower House of the Federal Parliament, printed matter) 15/3679 of 6 September 2004, at 21).

It should be noted that Sec. 50g(1), No. 1.b) aa) of the ITL deviates from Art. 1(5)(a) of the Directive in that the latter requires that "the debt claim.... is effectively connected with that permanent establishment" (in the German version of the Directive "*die Forderung... mit der Betriebsstätte in einem konkreten Zusammenhang steh(t)*", while the former states that the debt claim (etc.) has to effectively belong (in German "*tatsächlich zu der Betriebsstätte gehört*") to the permanent establishment. It thus may seem that Sec. 50g(1), No. 1.b) aa) of the ITL is narrower than Art. 1(5)(a) of the Directive in this respect. This different wording, however, does not necessarily have to lead to a difference in interpretation. In fact, while the terminology of the English version of Art. 1(5)(a) of the Directive in this respect is almost identical to Art. 11(4) of the OECD MC ("debt claim... effectively connected with such permanent establishment"), the German version of Art. 1(5)(a) of the Directive deviates from the German version of Art. 11(4) of the OECD MC ("*tatsächlich zu der Betriebsstätte gehört*"). It could thus be assumed that Sec. 50g(1), No. 1.b) aa) of the ITL merely took over the wording used in Art. 11(4) of the OECD MC, and in many German tax treaties, instead of the wording under the Directive. In respect of the interpretation of this criterion, it thus seems likely that the principles developed by German case law and legal doctrine with regard to the interpretation of Art. 11(4)/12(3) of the OECD MC and of the similar provisions under Germanys tax treaties are applicable. According to the PE Guidelines issued by the German Federal Ministry of Finance and to the case law of the Federal Tax Court, a functional connection between the business activities of the permanent establishment and the asset or property in question (i.e. in the case of interest or royalties, the debt-claim, right or use of information) is required (PE Guidelines, marginal note 2.4.; Federal Tax Court (*Bundesfinanzhof*) decision of 30 August 1995, case No. I R 112/94). The asset or property in question must assist in the execution of the predominant business activities carried on by the permanent establishment (Federal Tax Court, l.c.).

2.3.5. Permanent establishment in a third country (Art. 1(8))

Section 50g(1), 4th sentence of the ITL, the German provision implementing Art. 1(8) of the Directive, denies the exemption from tax under the Directive if the interest or royalties are paid to a PE of a company of a Member State as the creditor of the interest or royalties, located in a non EU Member State, through which the business of the company is wholly or partly carried on. The provision does not mention payments by a PE of a company of a Member State located in a non-EU Member State.

The implementing law does not provide guidance as to the interpretation of the requirement "business is wholly or partly carried on through that permanent establishment" in a third state. Since, however, the wording in that respect is equal to the wording in Sec. 50g(3), No. 5c of the ITL, the provision implementing Art. 3(c) of the Directive, it would appear that the requirement will be interpreted in the same manner (see question 2.3.1. above).

3. PROCEDURE

Germany implemented the procedural rules of the Directive in Secs. 50d and 50h of the ITL. Essentially, the same procedural rules as in respect of dividend withholding tax relief under the Parent-Subsidiary Directive apply, subject to certain amendments required by the Directive (e.g. new time-limits, interest if the tax withheld is not refunded in due time).

An exemption from the obligation to withhold tax at source or a refund of tax withheld is only available upon application. There is a decision and attestation requirement (based on Art. 1(12), (13) of the Directive).

No minimum holding period applies.

3.1. MINIMUM HOLDING PERIOD (ART. 1(10))

Germany did not make use of the option under Art. 1(10) of the Directive of not applying the benefits under the Directive to a company or permanent establishment in circumstances where the conditions set out in Article 3(b) of the Directive have not been maintained for an uninterrupted period of at least two years.

However, the letter instructing the tax authorities on the application of the benefits under the Directive until the entry into force of the implementing law requested the tax authorities to only grant the benefits of the Directive if the conditions set out in Article 3(b) of the Directive have been maintained for an uninterrupted period of at least two years. In applying this requirement, the tax authorities were to resort to the procedural rules implementing the similar requirement under the Parent-Subsidiary Directive.

The law implementing the Directive no longer contains this minimum holding period requirement. Since the provisions of the implementing law apply retroactively to payments made after 31 December 2003, the implementing law superseded the minimum-holding-period requirement under the letter.

In addition, it is established case law of the ECJ that EU Directives can only be implemented by law or governmental decree-law, but not by any other instrument lacking the status of a law (and not requiring the enactment procedure of a law) like a Ministry letter, which is only binding for the tax authorities, but not for the taxpayers or the tax courts. The Ministry letter thus does not qualify as a possible instrument to make use of an option under the Directive for purposes of applying the Directive. Consequently, the instruction of the German tax authorities to require observance of a minimum-holding-period requirement by the Ministry letter seems to have been null and void.

3.1.1. General

N/a.

3.1.2. Relief before the holding period requirement is satisfied

N/a.

3.1.3. Appeals

N/a.

3.2. ATTESTATION (ART. 1(11) AND 1(13))

For the requirements with regard to the required attestation, see question 3.3. below.

3.2.1. General

See question 3.3. below.

3.2.2. Appeals

See question 3.3. below.

3.2.3. Relief before the holding period requirement is satisfied

N/a.

3.3. DECISION ON APPLICATION OF THE RELIEF (ART. 1(12))

3.3.1. General

According to Sec. 50d(2), 1st sentence of the ITL, the debtor of the payment or remuneration may only refrain from withholding tax on interest or royalties paid if the Federal Tax Office (*Bundesamt für Finanzen*) has attested the creditor of the payment or remuneration that the requirements for it are met (exemption certificate - *Freistellungsbescheinigung*). The Federal Tax Office issues the exemption certificate on the basis of an application made by the creditor of the payments. The application has to be filed on the official application form issued by the Federal Tax Office (according to the letter instructing the tax authorities on the application of the benefits under the Directive until the entry into force of the law implementing the Directive, no specific form for the application was required before the entry into force of the implementing law). Upon the creditor's written authorisation, the application may also be made by a third person (e.g. the debtor of the payments or a representative of the creditor); the third person has to submit the authorisation to the Federal Tax Office.

The debtor must have the exemption certificate at the time he makes the payment (according to the official form for the application issued by the Federal Tax Office, the debtor automatically receives a copy of the exemption certificate), Sec. 50d(2), 5th sentence of the ITL.

The Federal Tax Office has to decide on the application within a period of three months (Sec. 50d(2), 6th sentence of the ITL). This period starts to run with the presentation of all evidence necessary for the decision to the Federal Tax Office (Sec. 50d(2), 7th sentence of the ITL). The Federal Tax Office may grant the exemption certificate subject to revocation, obligations or conditions (Sec. 50d(2), 2nd sentence of the ITL).

The validity period of the exemption certificate starts at the earliest at the day at which the Federal Tax Office receives the application for the exemption certificate. The validity period is at least one year and may not exceed three years. The creditor of the payment or remuneration is obliged to give notification without delay to the Federal Tax Office if the requirements for the exemption from the obligation to withhold tax cease to be met (Sec. 50d(2), 4th sentence of the ITL).

3.3.2. Supporting documents

According to the official application form issued by the Federal Tax Office, the applicant must provide the following information:

- creditor of the payment (name, legal form - street and house no. - domicile/seat, country - e-mail);
- debtor of the payment (name, residential address, e-mail, tax office and tax number);
- information according to Art. 1(13)(a) of the Directive:
  - place of the receiving company's residence for tax purposes (full address)
  - in case of the existence of a permanent establishment: place of the establishment (full address); the certificate of the foreign tax authority mentioned in Art. 1(13)(a);
- information according to Art. 1(13)(b) of the Directive:
  proof of the beneficial ownership by the receiving company according to Art. 1(4) of the Directive or the existence of the conditions according to Art. 1(5) of the Directive, where a permanent establishment is the recipient of the payment;
- information according to Art. 1(13)(d) in conjunction with Art .3(a)(iii) of the Directive:
  Exact name of the tax to which the payments are subject to in the country of residence; and a statement that the payments are not exempt from tax in the country of residence;
- information according to Art. 1(13)(d) and Art. 3(b) of the Directive:
  proof of the minimum holding in accordance with Art. 3(b) of the Directive;
- object of the contract (type of service - remuneration amount - contract has to be enclosed);
- date from which the exemption from the obligation to withhold tax shall apply - statement of the third person to which the exemption certificate shall be sent instead of to the applicant (the debtor of the payment automatically receives a copy of the exemption certificate);
- declaration of the applicant that (signed by the applicant or authorized representative, with statement of place and date):
  - the income is fully subject to the tax of the residence state;
  - to the best of the applicant's knowledge and belief, all particulars entered in this form are correct and complete in every respect; the applicant will promptly give notice of any change that may occur in future;

  The declaration has to be signed by the applicant or authorized representative, with statement of place and date;
- certificate of the tax authority of the applicant's country of residence, stating that:
  - the applicant (creditor of the payments) has its domicile/seat within the meaning of the income tax treaty at the place stated in the application, and
  - that the taxation of the payment will be checked.

  The certificate has to be signed by the tax authority, stating place, date, and official stamp.

3.3.3. Appeals

If the Federal Tax Office refuses to grant a certificate of exemption, the creditor of the payment (or, with his written authorization, the debtor) may file an appeal against the decision. Appeals must be filed within 1 month after the decision was received. It is generally assumed that the applicant receives the decision within 3 days after it was sent out by the tax authorities (1 month for non-residents). The filing period cannot be extended unless the reason for missing the deadline was beyond the control of the taxpayer or his representative.

If the applicant filed an appeal against the decision, the Federal Tax Office either issues a corrected decision (i.e. issues the exemption certificate) or rejects the appeal. If the appeal is rejected, the applicant has the possibility of starting proceedings at the tax court of first instance (*Finanzgericht*) within 1 month after he received the appeal decision of the Federal Tax Office. If the court decides against the taxpayer or the tax office, either of them may start proceedings at the Federal Tax Court, which is the tax court of last instance, provided that the appeal to the Federal Tax Court has been allowed either by the tax court of first instance or, upon, appeal against the non-allowance, by the Federal Tax Court. The appeal to the Federal Tax Court shall only be allowed if the underlying case is of basic significance, if purposes of further development of law or of a consistent jurisdiction require a decision by the Federal Tax Court, or if the decision by the tax court of first instance is based on non-compliance with the rules of procedural law. The decisions of the Federal Tax Court, however, may be taken to the Federal Constitutional Court (*Bundesverfassungsgericht*) on constitutional grounds.

The procedure described above does not differ from the appeal procedure that applies to other administrative acts or tax assessment notices.

3.4. APPLICATION FOR REFUND (ART. 1(15) AND 1(16))

Germany applies both the system of exemption at source and of deduction at source and refund.

3.4.1. General

According to Sec. 50d(1) of the ITL, the payer of interest or royalties must withhold tax at the full domestic rate regardless of whether the Directive, the Parent-Subsidiary Directive or a tax treaty provide for a reduced withholding tax rates or an exemption from withholding tax. The debtor of the payment generally may only refrain from withholding tax if he holds an exemption certificate as described above. Otherwise, the recipient of the income may apply for a refund of the tax withheld.

According to Sec. 50d(1), 3rd sentence of the ITL, the refund is made on the basis of an exemption notice (*Freistellungsbescheid*) issued by the Federal Tax Office. The Federal Tax Office issues the exemption notice on the basis of an application made by the creditor of the payments. The application has to be filed on the official application form issued by the Federal Tax Office (according to the letter instructing the tax authorities on the application of the benefits under the Directive until the entry into force of the law implementing the Directive, no specific form for the application was required before the entry into force of the implementing law). Upon the creditor's written authorisation, the application may also be made by a third person (e.g. the debtor of the payments or a representative of the creditor); the third person has to submit the authorisation to the Federal Tax Office. For the required content of the application, see question 3.3.2. above.

Applications for a refund of tax withheld can be filed during a period of four years following the expiry of the calendar year in which the payments were received (Sec. 50d(1), 7th sentence of the ITL). The period during which applications for refunds can be made does not end prior to the expiry of six months after the tax withheld has been transferred to the tax authorities (Sec. 50d(1), 8th sentence of the ITL).

The amount to be refunded is paid out after the notification of the exemption notice (Sec. 50d(1), 4th sentence of the ITL).

The tax authorities pay interest on the amount to be refunded (Sec. 50a(1a) of the ITL). The interest run starts twelve months after the expiry of the month in which the application for the exemption notice has been made and all the documents necessary for the decision have been presented to the Federal Tax Office; however, the interest run does not start before the day at which the debtor of the payments has transferred the amount of tax withheld to the tax authorities. The interest run ends with the expiry of the day at which the exemption notice has become effective (being the day of notification of the exemption notice). The interest rate is 0.5% per month (Sec. 50d(1a) in conjunction with Sec. 238(1) of the ITL) This rate also applies generally to tax refund claims of domestic taxpayers.

We do not have clear information on the average lapse of time between deduction at source and refund or application and refund.

3.4.2. Appeals

For the procedure to appeal a decision not to grant a refund, see question 3.3.3. above.

4. FRAUD AND ABUSE (ART. 5)

4.1. MEASURES UNDER ART. 5(1) OF THE DIRECTIVE

4.1.1. Domestic

The general anti-abuse provision in Germany is in Sec. 42 of the GTC. A structure is considered an abuse if it is unusual and if it was chosen exclusively for fiscal reasons. The anti-abuse provision, however, does not prohibit the use of fiscally advantageous structures. If there is at least one economic reason for the structure, in addition to the fiscal advantages, an abuse of law cannot be assumed.

If there is an abuse of law, the structure is disregarded for tax purposes, and the tax arises in the same way as if a structure that is similar from a civil law point of view and valid from a tax point of view had been used.

Additional anti-abuse provisions are the rules on the adjustment of inappropriate transfer prices and the rules governing hidden profit distributions (see above).

4.1.2. Agreement-based

Several tax treaties concluded by Germany with other Member States contain anti-abuse provisions according to which the provisions of the tax treaty shall not be interpreted to mean that a Contracting State is prevented from applying its domestic legal provisions on the prevention of tax evasion or tax avoidance (e.g. income tax treaties with Austria, Denmark, Malta, Poland, and Sweden).

Other tax treaties concluded by Germany with other Member States provide for a switch over from the exemption method to the credit method (after due consultation with the other Contracting State and/or notification via diplomatic channels) in order to prevent the exemption of income from taxation in both Contracting States or other structuring aimed at the abuse of the tax treaty provisions (e.g. income tax treaties with Estonia, Latvia, Lithuania).

It is not clear whether or not the German tax authorities will apply such anti-abuse provisions for transactions falling within the scope of the Directive.

4.2. MEASURES UNDER ART. 5(2) OF THE DIRECTIVE

Under the German provision implementing Art. 5(2) of the Directive, Sec. 50g(4) of the ITL, the benefits under the Directive are denied or withdrawn if the principal motive or one of the principal motives of a transaction is tax avoidance or abuse. So far, no guidance has been issued in respect of the application and interpretation of this provision. In addition to this provision that quite literally implements Art. 5(2) of the Directive, Sec. 50g(4) of the ITL states that the German anti-abuse provision aimed at the avoidance of treaty shopping and Directive shopping, Sec. 50d(3) of the ITL, is applicable.

Sec. 50d(3) of the ITL denies tax treaty benefits or benefits under the Parent-Subsidiary Directive or Interest and Royalties Directive (mainly reduction of withholding tax) to a non-resident (intermediate) company if and to the extent that:

- the shareholders of the intermediary company (the beneficial owners) would not be entitled to the treaty or Directive-based benefit;
- the use of the intermediary company does not have economic or other important reasons; and

- the intermediary company does not carry on own business activities.

All three conditions have to be met cumulatively in order to deny the application of the Directive or treaty relief.

The Directive or treaty relief is only denied to the extent that the shareholder of the foreign company, had he been the direct recipient of the income, would not have been entitled to the same relief.

There is little guidance on the interpretation of the term "economic or other important reasons". The German tax authorities claim that a company which has no trade and business activity of its own will hardly be able to demonstrate economic or other important reasons for its interposition between a foreign shareholder and a German subsidiary. The case law of the German Federal Tax Court, until recently, also failed to provide further guidance; it generally indicated that the criterion must be considered in conjunction with the criterion of "own trade and business activity".

In a recent decision, the Federal Tax Court partly reversed its above-described case law on the scope of Sec. 50d(3) (in the relevant years at issue, Sec. 50d(1a)) of the ITL (case I R 74, 88/04, decision of 31 May 2005). According to that decision, the existence of economic or other important reasons for the interposition of a foreign company can be assumed if:

– there are organizational or other business reasons for the interposition of the company, e.g. limitation of liability;
– the interposition of companies for purposes of holding participations in other foreign subsidiaries is a group wide, long-term policy; and
– there are also active companies of the group in the Member State of which the interposed company is a resident, so that the foreign company has not been interposed only for purposes of obtaining Directive or treaty benefits.

The decision furthermore indicates that, contrary to the court's previous case law (see below), it may be sufficient to meet the criterion of carrying on own business activities if not only one, but several participations in foreign subsidiaries are held.

The Federal Tax Court interpreted the requirement that the foreign shareholding company must conduct own trade and business activities in various decisions concerning "base companies". According to this case law, the term "own trade and business activity" requires an activity that goes beyond the mere holding of shares. It requires that a company conducts an activity of a general economic nature and participates in business transactions on the market. Under this case law, the mere fact that a holding company owns shares in more than one subsidiary is not in itself sufficient to fulfil the active trade and business test.

Furthermore, according to the German tax authorities, the activity of the foreign holding company must be economically connected with the ownership of the shares in the German subsidiary. An activity does not qualify under the active trade and business test if it is completely remote from the ownership of the shares and lacks any economic connection with the latter. Typical activities which have a connection with the ownership of shares include, among others, the financing of the respective subsidiaries and the centralization of other group functions, such as warehousing, distribution, marketing, advertisement and purchasing, where these functions are related to the subsidiaries' business activities.

4.3. Comparison with similar measures under Parent-Subsidiary and Merger Directives

As already mentioned above, no official guidance regarding the application and interpretation of the provisions implementing Art. 5 of the Directive has been issued so far.

Section 50d(3) of the ITL (from 1994 to 2002, Sec. 50d(1a) of the ITL) aims at the avoidance of tax treaty shopping and Directive shopping. It was introduced based on certain anti-abuse provisions under EU law (Art. 1(2) of the Parent-Subsidiary Directive) and tax treaties. It seems likely that the principles developed by the tax authorities and the tax courts with respect to the interpretation and application of Sec. 50d(3) of the ITL (see question 4.2. above) will accordingly apply for purposes of applying (or denying) the benefits under the Directive.

5. SUMMARY

Germany generally implemented the provisions of the Directive. Germany did not implement the Directive within the time limit specified by the Directive. However, the relevant provisions of the implementing law apply retroactively as from the date required by the Directive

Objective scope

In general, Germany implemented the definition of interest and royalty income set out in Art. 2 of the Directive. The German implementing provisions partly exclude payments from the definition that fall within the scope of the definition in Art. 2 of the Directive; however, these deviations are covered by Art. 4 of the Directive. Both interest and royalty payments are subject to the German transfer pricing and constructive dividend rules.

Subjective scope

Germany implemented the provisions laid down in Art. 3(a) of the Directive. Germany requires a direct shareholding in the capital as mentioned in Art. 3(b) of the Directive; Germany did not make use of the option to require a minimum holding of voting rights instead.

Germany grants the (withholding) tax exemption only to payments made by German eligible companies or by German permanent establishment of EU listed companies.

Germany seems to require that the receiving company is subject to corporate tax on the income received (objective tax requirement).

The definition of “permanent establishment” has been taken over in the implementing law. This definition differs from the PE definition under German domestic law; however, it seems likely that the term will be interpreted in accordance with the principles developed in respect of the interpretation of the PE definition under tax treaties and under the OECD MC (main rule).

Implementing the definition of the term “beneficial owner”, Germany did not follow the terminology used by the Directive, but referred to a concept existing under domestic law. However, it seems that the application of this domestic concept leads to the same results as the application of the terminology of the Directive.

Procedure

Germany generally implemented the provisions under the Directive. In Germany, both the system of exemption at source and of deduction at source and refund apply. Refraining from withholding tax at source / refund of tax withheld is only available on the basis of a decision (exemption certificate / exemption notice) issued by the Federal Tax Office. An application for refraining from withholding tax at source / for a refund is required.

Fraud and abuse

Germany will probably apply its domestic and agreement-based anti-abuse provisions. Germany quite literally implemented the anti-abuse provision under Art. 5(2) of the Directive. In addition, Germany's general provision aimed at the prevention of Directive shopping and treaty shopping applies; it seems likely that this provision will be interpreted in the same way as for purposes of the Parent-Subsidiary Directive.

PART II. THE AGREEMENT

INTRODUCTION

The German Ministry of Finance on 28 June 2005 issued a letter instructing the German tax authorities on the application of the relief to be granted under Art. 15 of the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (the “Agreement”). The letter instructs the German tax authorities to apply the relief provided by Art. 15(2) of the Agreement to interest and royalty payments to Swiss qualifying entities made after 30 June 2005. The letter announces that Art. 15(2) of the Agreement will be implemented into German domestic law by making amendments to Secs. 50g and 50h of the ITL, the German provisions implementing the Directive. To date, no Bill providing for such amendments has been presented to the Federal Parliament.

1. SCOPE

1.1. PAYMENTS

1.1.1. Concept of interest

Like Art. 15 of the Agreement, the Ministry letter does not contain a definition of the term "interest" for purposes of applying the relief. Since, however, the Directive was the basis of the negotiations on the Agreement, and since the Ministry letter states that Art. 15(2) of the Agreement will be implemented by amending Sec. 50g of the ITL (implementing the Directive), it seems likely that Germany applies the definition of the term "interest" under Sec. 50g of the ITL (which is in line with the definition under the Directive) for purposes of granting the relief under Art. 15(2) of the Agreement. For the concept of interest under Sec. 50g of the ITL, see question 2.1.1. above.

1.1.2. Concept of royalties

Similarly to Art. 15 of the Agreement, the Ministry letter does not contain a definition of the term "royalties" for purposes of applying the relief. Since, however, the Directive was the basis of the negotiations on the Agreement, and since the Ministry letter states that Art. 15(2) of the Agreement will be implemented by amending Sec. 50g of the ITL (implementing the Directive), it seems likely that Germany applies the definition of the term "royalties" under Sec. 50g of the ITL (which is in line with the definition under the Directive) for purposes of granting the relief under Art. 15(2) of the Agreement. For the concept of royalties under Sec. 50g of the ITL, see question 2.1.2. above.

1.2. COMPANIES

1.2.1. Types of companies benefiting from Art. 15(2) of the Agreement

According to the Ministry letter, Sec. 50g of the ITL applies accordingly, provided that one of the affiliated enterprises is an enterprise of the Swiss Confederation, or that a PE, situated in

Switzerland, of an enterprise of another Member State is the creditor of the interest or royalties. The letter defines an enterprise of the Swiss Confederation as every enterprise which:

(1) takes one of the legal forms mentioned in the footnote to Sec. 15(2), 4th indent of the Agreement;
(2) is a resident of Switzerland according to the Swiss tax laws and which is not regarded as being resident of a non Member State for tax purposes under the provisions of a tax treaty concluded between Switzerland and a non Member State; and
(3) is subject to unlimited Swiss corporate income tax liability without being exempt.

1.2.2. 'Affiliated' companies

The Ministry letter does not contain a definition of the term "affiliated company". However, since the letter states that the Agreement will be implemented by amending Sec. 50g of the ITL (implementing the Directive), and that Sec. 50g of the ITL applies accordingly to payments to qualifying Swiss enterprises, it seems likely that Germany applies the holding requirements under Sec. 50g of the ITL also to situations covered by the Agreement (for the holding requirements under Sec. 50g of the ITL, see question 2.2.4 above). It thus appears that, even though provided otherwise by the Agreement, Germany does not require the holding to exist for at least two years.

1.2.3. Residence requirement

According to the Ministry letter, Sec. 50g of the ITL applies accordingly, provided that one of the affiliated enterprises is an enterprise of the Swiss Confederation, or that a PE, situated in Switzerland, of an enterprise of a Member State is the creditor of the interest or royalties. The letter defines an enterprise of the Swiss Confederation as every enterprise which:

(1) takes one of the legal forms mentioned in the footnote to Sec. 15(2), 4th indent of the Agreement;
(2) is a resident of Switzerland according to the Swiss tax laws and which is not regarded as being resident of a non Member State for tax purposes under the provisions of a tax treaty concluded between Switzerland and a non Member State; and
(3) is subject to unlimited Swiss corporate income tax liability without being exempt.

1.2.4. Subject-to-tax requirement

According to the Ministry letter, Sec. 50g of the ITL applies accordingly, provided that one of the affiliated enterprises is an enterprise of the Swiss Confederation, or that a PE, situated in Switzerland, of an enterprise of another Member State is the creditor of the interest or royalties. The letter defines an enterprise of the Swiss Confederation as every enterprise which:

(1) takes one of the legal forms mentioned in the footnote to Sec. 15(2), 4th indent of the Agreement;
(2) is a resident of Switzerland according to the Swiss tax laws and which is not regarded as being resident of a non Member State for tax purposes under the provisions of a tax treaty concluded between Switzerland and a non Member State; and
(3) is subject to unlimited Swiss corporate income tax liability without being exempt.

2. PROCEDURE

In order to ensure the application of the relief under Art. 15(2) of the Agreement, the Ministry letter refers to Sec. 50d of the ITL, the German provision governing the application of the withholding tax relief for purposes of the Directive, the Parent-Subsidiary Directive and tax treaties. In consequence, the same procedural rules as described in question 3. above apply.

3. SUMMARY

Germany did not (yet) legally implement Art. 15(2) of the Agreement (which is probably not mandatory according to the legal character of the Agreement). Instead, a Ministry letter instructs the tax authorities on the application of the relief in relation to Switzerland.

The Ministry letter does not appear to contain rules specifically making reference to the provisions of Art. 15(2) of the Agreement. Instead, the letter simply appears to include Switzerland within the scope of Secs. 50g, 50h and 50d of the ITL, the provisions implementing the Directive.

ANNEX

Table of the maximum withholding tax rates on interest and royalty payments under the tax treaties between Germany and the EU Member States.

EU Member State	Interest<1>	Royalties
Austria	0	0
Belgium	0/15<2>	0
Cyprus	10	0/5<7>
Czech Republic	0	5
Denmark	0/25<3>	0
Estonia	10<4>	5/10<8>
Finland	0	0/5<9>
France	0	0
Greece	10	0
Hungary	0	0
Ireland	0	0
Italy	0/10 <4> <5>	0/5 <9>
Latvia	10 <4>	5/10 <8>
Lithuania	10 <4>	5/10 <8>
Luxembourg	0	5
Malta	0 <4>	0
Netherlands	0/15 <3>	0
Poland	5 <4>	5
Portugal	10/15 <4> <6>	10
Slovak Republic	0	5
Slovenia <10>	0<4>	10
Spain	10	5
Sweden	0<4>	0
United Kingdom	0	0

<1> Many treaties provide for an exemption for certain types of interest, e.g. interest paid to public bodies and institutions or in relation to sales on credit. These exemptions are not indicated in the chart. Although interest on loans secured by German-situs

immovable property (mortgage loans) is taxed by assessment rather than by withholding, a treaty can exclude German taxation or reduce the rate.

<2> No tax is imposed if the recipient is a Belgian enterprise, except for interest on bonds and interest paid to a corporate shareholder owning at least 25% of the paying company's voting power or shares.

<3> The higher rate applies to profit-dependent interest, such as profit-sharing bonds.

<4> The treaty does not limit the taxation of profit-dependent interest (e.g. profit-sharing bonds).

<5> The 0% rate applies to interest on public bonds.

<6> The lower rate applies to interest paid to a bank; conditions may apply.

<7> The higher rate applies to royalties for films, etc.

<8> The lower rate applies to equipment rentals.

<9> The lower rate applies to copyright royalties, including films, etc.

<10> The treaty concluded between Germany and the former Yugoslavia.