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Highlights of the new Germany – Netherlands tax treaty

On 12 April 2012, the new German – Netherlands tax treaty was signed ("the Treaty"). The Treaty replaces the current treaty from 1959, which had been updated multiple times through Protocols. The Treaty is scheduled to enter into effect on 1 January 2014.

1. Treaty residence

The Treaty includes the OECD Model Convention 'standard' residency clause, and tie-breaker for entities (place of effective management).

Under Article II of the Protocol to the Treaty, all entities which are residents of the Netherlands for purposes of the Dutch Corporate Income Tax Act are eligible for treaty benefits, provided that their income is treated as income of that entity and not of its participants, members, or beneficiaries. This means that pension funds, fiscal investment funds ("FBI") and exempt investment funds ("VBI"), as well as charitable organizations will become eligible to treaty benefits.

Under article 29 of the Treaty, managers or managing partners of investment funds or partnerships are able to claim treaty benefits for and on behalf of their underlying partners/investors if and to the extent such underlying partners/investors are entitled to treaty benefits.

2. Permanent establishment

The Treaty includes the OECD Model Convention 'standard' permanent establishment ('PE') clause (construction sites and installation projects deemed to be PE's if duration exceeds 12 months), however with the addition of an 'offshore paragraph'. Off shore activities are deemed to constitute a PE, unless the duration of such activities, performed in one or more periods in any 12-month period, is less than 30 days. The duration of off shore activities performed by related companies is added together whereby, in case the total combined duration is 30 days ore more, each company involved is deemed to have a PE.

3. Business profits and 'associated enterprises'

The Treaty includes the 2010 version of the business profits allocation provision, as well as the 'standard' provision for associated enterprises. This means a 'separate entity approach' for PE profit allocation, recognition of the at arm's length principle and corresponding adjustments, and mutual agreement procedures in case of (residual) double taxation.

4. Withholding taxes

Like the current treaty, the Treaty allocates the right to levy tax on interest and royalties exclusively to the residence state. Dividends are taxable in both the residence state and the source state, whereby the right of the source state to levy tax is limited to:

1. 5% if the recipient of the dividends is the beneficial owner, holding 10% or more in the capital of the company paying the dividend ('participating interests'),
2. 10% if the recipient is a qualifying pension fund resident in the Netherlands, and
3. 15% in all other situations.

In practice, the EU parent subsidiary directives will reduce the withholding tax on participating interests to 0%.

As the Netherlands already allows a full refund of Dutch dividend withholding tax to EU/EEA resident exempt investors (such as pension funds), and exempt investors resident in designated non-EU member states to the extent it relates to portfolio investments, the rate reduction in the Treaty only applies to Dutch pension funds receiving dividends from Germany.

Interest and dividends derived from profit participating rights and loans may be taxed in the source state (taking into account the rates prescribed by the Treaty), provided that such interest or dividends are deductible in the source state from the income of the debtor of such interest or dividends.

5. Employment income

In accordance with the OECD Model Convention, the Treaty allocates the right to levy tax on employment income (on a pro rata basis) to the country(-ies) where the work is performed, with a possible exclusive right to tax for the residence state in case of short term secondments (183-day rule).

The Treaty allocates the right to tax employment income of personnel aboard aircraft, ships, and inland waterways transport to the country of residence of the employee, unlike the current treaty and the OECD Model Convention, which allocate the right to levy such tax to the country where the effective management of the employer is located.

Pension payments and similar periodic income is taxable only in the residence state. However, if the gross income exceeds € 15,000 per year, the source state is also allowed to tax such income, but only to the extent that contributions had been tax deductible in the source state.

Finally, the article VII of the Protocol contains a special compensation regime for residents of the Netherlands who work in Germany. If the total amount of income tax and social insurance premiums due in the Netherlands and in Germany exceeds the total amount of Dutch income tax and social insurance premiums that would have been due if the person had earned his whole income in the Netherlands, the Netherlands will compensate such additional burden. Conversely, if the total amount of income tax and social insurance premiums due in the Netherlands and Germany is less than the amount of Dutch income tax and social insurance premiums that would have been due if the person had earned his whole income in the Netherlands, no additional Dutch income tax or social insurance premiums will be due. The compensation regime applies not only to employees, but also to sportsmen, artists, and (supervisory) directors.

6. Anti avoidance

The Treaty contains a general anti avoidance rule only, no specific anti abuse rules. Article 23 of the Treaty allows the Netherlands and Germany to apply their domestic legal provisions to counter tax evasion or tax avoidance. It can be questioned whether article 23 also allows the application of the Dutch abuse of law doctrine, as such doctrine has not been laid down in ‘domestic legal provisions’. If the application of anti abuse measures results in double taxation or taxation which is not in accordance with the Treaty, at the request of the taxpayer the competent authorities of the Netherlands and Germany will consult each other in a mutual agreement procedure as meant in article 25 of the Treaty.