

PROTOCOL SIGNED TO AMEND THE UK/GERMANY DOUBLE TAXATION TREATY

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The UK and Germany signed a protocol to the UK/Germany Double Taxation Treaty (the DTT) on 12 January 2021 to implement certain “BEPS” measures aimed at preventing treaty abuse. On the same day, the UK and Germany signed a joint declaration affirming their willingness to enter into further treaty negotiations by 31 December 2021 to tackle the consequences of Brexit on double taxation.

"Under a new Article 30a, any treaty benefit shall not be granted in respect of any income or capital if obtaining the treaty benefit was one of the principal purposes of the arrangement or transaction."

THE AMENDMENTS

The signed protocol comprises the following significant amendments to the DTT:

- The amended title and preamble of the DTT makes the *intention* of the parties (i.e. the UK and Germany) clear that the DTT should not create “double non taxation” or other avoidance opportunities (including treaty shopping);
- In line with the intention of the DTT, a principle purpose test (PPT) has been introduced. Under a new Article 30a, any treaty benefit shall not be granted in respect of any income or capital if obtaining the treaty benefit was one of the principal purposes of the arrangement or transaction. The previous specific anti-abuse rules for dividend, interest and license payments, as well as for income not covered by a specific treaty provision, will be removed as they are covered by the

broader PPT. In contrast to the specific anti-abuse rules, the PPT allows the taxpayer to prove that granting the treaty benefit is in accordance with the objective and purpose of the DTT; and

- To prevent the avoidance of a permanent establishment by using the exceptions for preparatory and auxiliary activities under Article 5 para. 4 DTT (i.e. splitting of activities), an anti-fragmentation rule is implemented in the protocol. Under this rule, activities carried out by an enterprise of one state within the other jurisdiction (e.g. a UK enterprise carrying out activities in Germany) or activities carried out by a closely related enterprise within the other jurisdiction may be combined in assessing whether a permanent establishment arises. A fixed place of business in which, on a stand-alone basis, only preparatory or auxiliary activities are carried out, may no longer fall within the exceptions from qualifying as a permanent establishment for the purposes of the DTT due to other activities carried out in the same jurisdiction (i.e. Germany or the UK).

ENTRY INTO FORCE

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The protocol must be ratified before coming into force and may become effective from (at the earliest) 1 January 2022 in Germany and April 2022 in the UK, with a potentially earlier effective date of 1 January 2022 for taxes imposed by way of withholding.

PRACTICAL IMPACT

"Taxpayers currently benefitting from the DTT should review their position and analyse whether a tax benefit might be identified as one of the principal purposes for a chosen transaction or arrangement."

Where a business or group has operations in the other jurisdiction which do not currently generate a permanent establishment, the new anti-fragmentation rule should be carefully considered. For instance, the use of facilities for the purpose of storage, display or delivery of goods or merchandise may be treated as (part of) a permanent establishment, no longer falling within the exceptions of the current DTT.

Any arrangements and transactions which currently benefit from the protection of the DTT should be evaluated in light of the new PPT. The impact might not be significant for dividend, interest and license payments given the existing specific anti-abuse rules of the DTT. However, the now-implemented PPT rule applies to any treaty benefit, resulting in a much broader scope. As an overriding principle, the PPT serves as an additional instrument for the UK and German tax authorities to fight treaty abuse. Therefore, taxpayers currently benefitting from the DTT should review

their position and analyse whether a tax benefit might be identified as one of the principal purposes for a chosen transaction or arrangement.

On the positive side, beneficial amendments to the DTT for UK and German businesses are expected thanks to the further planned Brexit-related negotiations between the UK and Germany. It is possible that the German withholding tax rate on dividends may be lowered, given that the EU parent-subsidiary directive no longer applies to UK investors in German companies

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