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## Proposal to Amend the German Anti-Treaty Shopping Provision

An amendment of the German anti-treaty-shopping provision was proposed by the Finance Committee of the German Federal Parliament (*Finanzausschuss des Deutschen Bundestages*) on October 26, 2011.

The German anti-treaty shopping provision is relevant for non-resident corporations that rely on a double tax treaty or on the EU Parent-Subsidiary-Directive to claim an exemption from or a reduction of German withholding tax. Under this anti-abuse rule benefits are denied to the extent that (i) shareholders of non-resident corporations would not be entitled to a reduced withholding tax rate if they received the income directly ("Non-Qualifying Shareholders"), and (ii) one of three additional tests is not satisfied.

Currently, one such additional test stipulates that more than 10% of the non-resident corporation's income must qualify as active income *i.e.*, income derived from genuine commercial activities (as opposed to passive income, for example derived from managing own assets). The 10% threshold was criticized in the past as an overly broad limitation. Taxpayers could not prove the economic merit of their specific cases. Also, the European Commission considered the 10% threshold disproportionate and formally requested Germany to amend the provision.

Pursuant to the new proposal, the 10% threshold shall be abolished. A reduction of the withholding tax rate shall be denied to the extent that Non-Qualifying Shareholders participate in the non-resident corporation, and it derives passive income, and

- (i) there are no economic or *bona fide* reasons for interposing the non-resident corporation with respect to such passive income, or
- (ii) the non-resident corporation lacks substance.

The burden of proof with respect to (i) and (ii) lies with the taxpayer. The wording of the proposal is not clear in all its particulars and will also result in an additional administrative burden. The proposal is part of a pending legislative initiative and would come into force on January 1, 2012. The proposal is on the agenda of today's meeting of the German Federal Parliament.

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