Executive summary

The New China-Germany Income Tax Treaty (the New Treaty) and its Protocol (Protocol) entered into force on 5 April 2016 and will become effective on 1 January 2017. The New Treaty and Protocol were signed on 28 March 2014, replacing the existing treaty that was signed on 10 June 1985.

Significant changes in the New Treaty include:

- Definition of permanent establishment (PE) (Article 5)
- Withholding taxes for dividends and royalties (Articles 10 and 12)
- Tax relief on capital gains from the alienation of shares (Article 13)
- Taxes on independent personal services (Article 14)
- Taxes on income from employment (Article 15)
- New anti-abuse rules (Article 29)

This Alert summarizes the key changes in the New Treaty.

Detailed discussion

PE definition – Article 5

The New Treaty changes the PE definition on Construction PE and Service PE:
> Construction PE – A building site, or construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than 12 months - an increase from 6 months.

> Service PE – The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days within any 12-month period - a change from the 6 months within any 12-month period.

Business Profits – Article 7
As the treaty was negotiated in 2014, the Business Profits Article was phrased on the basis of the 2008 Organisation for Economic Co-operation and Development (OECD) Model and does not include the income allocation concept formulated by the 2010 Authorized OECD Approach, which is now the standard for all new German tax treaties.

Dividends and Royalties – Articles 10 and 12
The New Treaty reduces the withholding tax rate on dividends to 5% from 10% if a corporate beneficial owner directly holds at least 25% of equity interest in the distributing company. However, the New Treaty also includes a new 15% rate applicable to distributions paid out of income or gain directly or indirectly derived from immovable property by an investment vehicle. In all other cases, the current 10% applies.

The New Treaty provides a reduced 6% effective rate for royalty payments for the use of, or the right to use, any industrial, commercial or scientific equipment. In all other cases, the rate remains at 10%.

Capital gains – Article 13
The New Treaty provides relief from capital gains tax on certain share dispositions. Gains derived by a resident of a Contracting State from the alienation of shares of a company which is a resident of the other Contracting State may only be taxed in that other Contracting State under the following situations:

> If more than 50% of the value of the shares represents directly or indirectly immovable property

Or

> If the transferor holds directly or indirectly no less than 25% of the shares of the disposed company for the 12-month period preceding the share transfer, excluding the situation where the shares are substantially and regularly traded on a recognized stock exchange and the total of the shares disposed by the transferor during the fiscal year in which the disposal takes place does not exceed 3% of the quoted shares.

Gains from the alienation of shares other than the above shall be taxable only in the Contracting State of which the alienator is a resident.

Independent personal services – Article 14
If a resident of a Contracting State stays in the other Contracting State for a period or periods amounting to or exceeding in the aggregate 183 days in any 12-month period commencing or ending in that fiscal year, the resident’s income derived from his activities performed in that other State may be taxed in that other State.

Income from employment – Article 15
Remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State will be taxable only in the first-mentioned State if all the following conditions are met:

> The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in that fiscal year.

> The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State.

> The remuneration is not borne by a PE or a fixed base which the employer has in the other State.

Anti-abuse rules – Article 29
The New Treaty provides new anti-abuse rules and allows both contracting states to apply domestic laws concerning the prevention of tax evasion and avoidance.

Endnote
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