

UK ratifies protocol to UK / Germany double tax treaty

Background

The UK ratified the **protocol** to its double tax treaty (DTT) with Germany on 26 May 2021 (**SI2021/634**), giving UK domestic effect to the protocol which was signed by the two countries on 12 January 2021. Germany has also recently incorporated the protocol into its domestic legislation (Fed Gazette 259/21 of 23 July 2021). Exchange of instruments of ratification is therefore expected shortly. The protocol will come into force on the day that exchange takes place and will have effect:

In the **UK, for income tax and capital gains tax**, for tax years beginning on or after 6 April in the year following entry into force, and, for corporation tax, for financial years beginning on or after 1 April, in the year following entry into force – now expected to be 1 April 2022.

1

For **taxes withheld at source**, for amounts paid (Germany) or income derived (UK) on or after 1 January in the year following entry into force – now expected to be 1 January 2022.

2

In **Germany, for other taxes on income**, for fiscal years beginning on or after 1 January in the year following entry into force – now expected to be 1 January 2022.

3

In detail

The key changes introduced by the protocol relate to:



Tax evasion and avoidance

Reflecting the intent of the UK and Germany that the treaty should not create opportunities for tax evasion and avoidance (such as anti- treaty shopping) by amending title and preamble of DTT.



Prevention of Treaty Abuse

Incorporating the principal purpose test (PPT) in accordance with the OECD BEPS minimum standard. Under the PPT, treaty benefits will not be granted in respect of any item of income or capital if obtaining the treaty benefit was one of the principal purposes of the arrangement or transaction that resulted (directly or indirectly) in that benefit. Existing 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. In contrast to these specific anti-abuse rules, the PPT will not deny treaty relief if the taxpayer can prove that granting the treaty benefit in such circumstances is in accordance with the objective and purpose of the DTT.



Permanent establishments

Insertion of an anti-fragmentation rule, consistent with other UK treaties amended using the MLI. This prevents the avoidance of a PE by using the exceptions for preparatory and auxiliary activities. Activities carried out in one state by an entity of the other state (e.g. a UK company carrying out activities in Germany) and even by another entity which is closely related (broadly assumed in case of 50% of vote and value or beneficial equity ownership relationships) may be combined in assessing whether a PE arises. A fixed place of business in which only preparatory and/or auxiliary activities are carried out, may no longer fall within the exceptions from qualifying as a PE for the purposes of the DTT if there are other activities carried out in the same jurisdiction.



Mutual Agreement Procedure (MAP)

Amended so that there is no longer an exception that qualifies the obligations of the Competent Authorities to implement any agreement reached irrespective of any domestic law time limits.

The changes are in line with the German Government's position relative to the cautious implementation of the suggestions of the OECD-Multilateral Instrument (<https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>) into its DTTs, while not following the complex two-tier implementation procedure Germany has elected. At the time of signing the Protocol and the accompanying memorandum on 12 January 2021, both Governments also signed a Joint Declaration pursuant to which both Countries affirm their willingness to enter into negotiations for a further amendment of the DTT within 12 months of the end of the Brexit transition period, i.e. before the end of 2021 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/955612/Germany-UK-2021-Joint-Declaration_01_14_21.pdf)

Note that the protocol does not include any reduction of withholding tax (WHT) rates, and therefore the 5% WHT payable on dividends remains problematic for dividends paid by German companies to UK recipients as a consequence of UK companies ceasing to be able to benefit from the EU's Parent Subsidiary Directive from 1 January 2021 following Brexit. HMRC is prioritising treaty discussions with Germany as a method for dealing with this, as discussed in their stakeholders meeting in January 2021.

Takeaway

The protocol is unlikely to have significant impact in the UK or Germany, but may create additional challenge on the PE status of UK groups with large operations in Germany where selling is not being done via a local German company (see PE comments above). We must wait to see how treaty negotiations develop in relation to the 5% WHT and whether these negotiations will be extended to encompass additional changes.

Contacts

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