Re US S Corporation's German withholding tax status

I R 48/12

BUNDESFINANZHOF (FEDERAL TAX COURT)
JUDGMENT DATE: 26 JUNE 2013

Double taxation conventions – Germany – Resident – Deemed residence – Whether fiscally-transparent US company resident in US – Income taxable in hands of shareholders in US – Whether 'treaty-eligible person' and beneficial owner of dividend paid to it – German-US double taxation convention, arts 1.7, 3.1(d), 4.1, 10.2(1)(a).

The taxpayer was a US company which had elected under US tax law to be an 'S' Corporation, that is to say it would be fiscally-transparent and its income would be taxed in the hands of its shareholders, all of whom were resident in the US. The S Corporation was the owner of 50 per cent of the shares in a German company. In 2008, the German company distributed a profit of over €1m but deducted withholding taxes of over 20 per cent. The taxpayer applied for a refund on the basis that as it owned over 10 per cent of the German company it was entitled to the reduced withholding tax under art 10.2(1)(a) of the German-US double taxation convention as amended in 2008. The German tax authority conceded that it was entitled to a partial refund under art 10.2(1)(b) and the taxpayer appealed unsuccessfully to the local tax court and then to the BFH.

Held (allowing the appeal):

(1) The S Corporation qualified as the beneficial owner of the dividend under German law, notwithstanding that it was fiscally-transparent under US law. The S Corporation, according to a comparison of types test, had a legal structure similar to a corporation and therefore for the purposes of German tax law was a company within the meaning of art 3.1(e) of the German-US double taxation convention. Although it was not a company resident in the other contracting state under art 4.1 of the convention as it was not itself liable to tax in the US, under art 1.7 of the convention the income was deemed to be derived by a resident of the US to the extent that it was taxable in the hands of the shareholders who were resident in the US. The S Corporation was therefore deemed to be a 'treaty-eligible

person' and the income was deemed to be derived by a US resident person (see bb), aaa), bbb), below).

(2) The S Corporation, being a treaty-eligible person which owned more than ten per cent of the distributing corporation, was entitled to the reduced withholding tax under art 10.2(1)(a) of the double taxation convention (see paras b), aa), below).

Per curiam

The question whether the taxpayer might possibly claim a refund of the withholding tax on the ground that it is in violation of the free movement of capital guaranteed under EU law does not arise for decision in this proceeding (see para 4, below).

EDITOR'S NOTE

There are a number of interesting issues discussed in this case, not least of which is the application of the Dividends Article of the US-Germany treaty of 1989 to a dividend paid by a German GmbH to a US S corporation which had elected to be treated as transparent for US tax purposes. Since the Judgment discusses various versions of the treaty, it may be helpful here to set out the text of the relevant provisions at different times.

The original US-Germany DTC in 1989 (referred to in the Judgment as the US-German DTC 1989/1991) provided as follows:

> '**Article 1**
>
> ***Personal Scope***
>
> This Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in this Convention.
>
> **Article 3**
>
> ***General Definitions***
>
> 1. For the purposes of this Convention, unless the context otherwise requires:
>
> d) the term "person" includes but is not limited to an individual and a company;
>
> e) the term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes;
>
> 2. As regards the application of this Convention by a Contracting State any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a common meaning pursuant to the provisions of Article 25 (Mutual Agreement Procedure), have the meaning that it has under the laws of that State concerning the taxes to which this Convention applies.
>
> **Article 4**

Residence

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that

a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein; and

b) in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.

Article 10

Dividends

1. Dividends paid by a company that is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State the tax so charged shall not exceed:

a) 5 percent of the gross amount of the dividends if the beneficial owner is a company that holds directly at least 10 percent of the voting shares of the company paying the dividends; and

b) 15 percent of the gross amount of the dividends in all other cases.

3. As long as a natural person resident in the Federal Republic of Germany is entitled under German law to a tax credit (Anrechnung der Koerperschaftsteuer) in respect of dividends paid by a company that is a resident of the Federal Republic of Germany, the following rules shall apply to dividends paid by such company:

a) the beneficial owner of dividends subject to paragraph 2 b) shall be entitled to a further relief of tax of 5 percent of the gross amount of the dividends; and

b) for United States income tax purposes (including for the purposes of credit for foreign taxes paid) the benefit resulting from the application of subparagraph a) shall be treated as a dividend paid to a beneficial owner resident in the United States.'

This was amended by a protocol of 2006 (referred to in the Judgment as the Amendment Protocol) which contained the following provisions:

'Article I

Article 1 (Personal Scope) of the Convention is deleted and the following Article substituted:

> "Article 1
>
> General Scope
>
> 1. This Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in this Convention.
>
> …
>
> 7. In the case of an item of income, profit or gain derived by or through a person that is fiscally transparent under the laws of either Contracting State, such item shall be considered to be derived by a resident of a State to the extent that the item is treated for the purposes of the taxation law of such State as the income, profit or gain of a resident."

Article II

Article 4 (Residence) of the Convention is amended by deleting paragraph 1 and substituting the following paragraph:

> "1. For the purposes of this Convention, the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. The term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State or capital situated therein."

Article IV

Article 10 (Dividends) of the Convention is deleted and the following Article substituted:

> "Article 10
>
> Dividends
>
> 1. Dividends paid by a company that is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
>
> 2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the dividends are derived and beneficially owned by a resident of the other Contracting State, the tax so charged shall not exceed:

a) 5 percent of the gross amount of the dividends if the beneficial owner is a company that owns directly at least 10 percent of the voting stock of the company paying the dividends;

b) 15 percent of the gross amount of the dividends in all other cases. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid."

Article XVII

1. This Protocol shall be subject to ratification and the instruments of ratification shall be exchanged as soon as possible.

2. This Protocol shall enter into force on the date on which the instruments of ratification are exchanged and shall have effect in both Contracting States:

a) in respect of taxes withheld at source, for amounts paid or credited on or after the first day of January of the year in which this Protocol enters into force;

b) in respect of other taxes on income for any taxable year beginning on or after the first day of January next following the date this Protocol enters into force; and

c) in respect of taxes on capital for the taxes levied on items of capital owned on or after the first day of January next following the date this Protocol enters into force.

3. Notwithstanding the provisions of paragraph 2,

a) the provisions of paragraphs 2 and 3 of Article 1 (General Scope) shall have effect after the entry into force of this Protocol and shall apply in respect of any tax claim irrespective of whether such tax claim pre-dates the entry into force of this Protocol or the effective date of any of its provisions; and

b) the amendments made by Article X of this Protocol shall not have effect with respect to individuals who, at the time of the signing of the Convention, were employed by the United States, a political subdivision or local authority thereof.

5. Notwithstanding paragraph 2, where any person entitled to benefits under the Convention as unmodified by this Protocol would have been entitled to greater benefits thereunder than under the Convention as modified by this Protocol, the Convention as unmodified shall, at the election of such person, continue to have effect in its entirety with respect to such person for a twelve-month period from the date on which the provisions of this Protocol would have effect under paragraph 2 of this Article.'

Thus, the amended convention (referred to in the Judgment as the US-German DTC 1989/2008), which applied at the time that the dividend was paid in 2008, contained the following provisions:

'Article 1

General Scope

1. This Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in this Convention.

7. In the case of an item of income, profit or gain derived by or through a person that is fiscally transparent under the laws of either Contracting State, such item shall be considered to be derived by a resident of a State to the extent that the item is treated for the purposes of the taxation law of such State as the income, profit or gain of a resident.

Article 3

General Definitions

1. For the purposes of this Convention, unless the context otherwise requires:

d) the term "person" includes but is not limited to an individual and a company;

e) the term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes;

2. As regards the application of this Convention by a Contracting State any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a common meaning pursuant to the provisions of Article 25 (Mutual Agreement Procedure), have the meaning that it has under the laws of that State concerning the taxes to which this Convention applies.

Article 4

Residence

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. The term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State or capital situated therein.

Article 10

Dividends

1. Dividends paid by a company that is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and

according to the laws of that State, but if the dividends are derived and beneficially owned by a resident of the other Contracting State, the tax so charged shall not exceed:

a) 5 percent of the gross amount of the dividends if the beneficial owner is a company that owns directly at least 10 percent of the voting stock of the company paying the dividends;

b) 15 percent of the gross amount of the dividends in all other cases. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.'

As explained in the Commentary below, the US corporation was not liable to tax in the US by virtue of the election to treat it as an S corporation and transparent. However, under art 1(7) of the Convention (which had been added by the 2006 Amendment Protocol) it was possible to look through to the shareholders who were liable to tax. Having decided, therefore, that it was possible to apply the Dividend Article even though the corporation was not a resident of the US, the BFH nevertheless treated the corporation as the recipient of the dividends and their beneficial owner, by applying the German characterisation of the entity as a corporate entity, and as the beneficial owner under the meaning in German law. As a consequence, the withholding tax in Germany was applied at the lower, 5% rate, applicable to a beneficial owner which is a company owning at least 10% of the share capital. This, highly advantageous treatment meant that the company did not need to rely upon the provision in art XVII(5) of the Amendment Protocol which preserved the prior treatment for 12 months if more advantageous.

COMMENTARY

Judgment by the German Federal Fiscal Court—Application of Article 1, paragraph 7 Double Tax Treaty Germany-USA

I. Background and Introduction

The decision of the German Federal Fiscal Court under review is the first one interpreting art 1 para 7 of the German-US double tax treaty revised in 2006 (hereinafter DTT).

Article 1 para 7 DTT has almost the same wording as art 1 para 6 of the US-model tax treaty. The provisions seek to improve the applicability of the DTT in case of 'hybrid' entities, which are qualified as fiscally transparent in one of the contracting states and as fiscally non-transparent in the other contracting state. Due to this conflict of qualification several issues can arise when applying the DTT. The Technical Explanations to art 1 para 6 of the US-model tax treaty state that the risk of double taxation and double non-taxation is relatively high. Therefore art 1 para 6 was introduced into the US-model tax treaty.

As art 1 para 7 DTT is similar to respective clauses in many US double tax treaties and some further German treaties, the judgment of the Federal Fiscal Court could be considered in numerous cases in which such a clause is applied by the source state. The judgment is particularly interesting as it deals with withholding tax (hereinafter WHT) on dividends. As with respect to interest and royalties, relief from source state taxation requires that the person receiving the payment is a resident of the other contracting state and the beneficial owner. In addition, the applicable WHT rate on dividends depends on whether or not the person receiving the dividends is a corporation which holds a qualifying stake in the distributing company.

From a German tax perspective, new issues will arise following the introduction of s 50d para 1 sentence 11 German Income Tax Act (GITA) for payments made to hybrid entities from 1 July 2013 onwards (see III, below).

II. Judgment by the German Federal Fiscal Court dated 26 June 2013 (*I R 48/12*)

The German Federal Fiscal Court decided with its judgment dated 26 June 2013 and published in October 2013 that an 'S Corporation', which is treated as fiscally transparent from a US tax perspective and fiscally non-transparent from a German tax perspective, qualifies for a WHT tax reduction to 5% under the German-US DTT. In the case under review, the S Corporation held a participation of 50% in a German-resident GmbH. The shareholders of the S Corporation were individuals residing in the US. In 2008, the GmbH distributed a dividend to the S Corporation and deducted from the amount distributed the German WHT of 20% applicable at that time (currently 25%) plus solidarity surcharge (in total 21.1%, now 26.375%). The S Corporation applied for a refund of the WHT down to 5% according to art 10 para 2 lit. a DTT. A possible reduction to 0% according to art 10 para 3 DTT was not applied for since in the underlying case the participation in the GmbH was less than the required 80%. The German Federal Central Tax Office refused to reduce the WHT to 5%. It was of the opinion that the plaintiff, being an S Corporation and transparent for US tax purposes, does not qualify for the reduced WHT of 5% but only for a WHT rate of 15%.

The S Corporation filed a tax law suit at the Fiscal Court of Cologne which is the competent court for all lawsuits against the German Federal Central Tax Office.

The legal dispute at the Fiscal Court of Cologne (judgment of 24 April 2012, 2 K 3928/09, Internationales Steuerrecht 2012, p 667 et seq) did not end successfully for the plaintiff. The Fiscal Court denied the applicability of the 5% WHT rate since the S Corporation is not a 'resident' in the sense of art 4 para 1 sentence 1 DTT. In the German tax literature, it was highly disputed if after the abolition of art 4 para 1 lit. b and Protocol No 10 of the double tax treaty of 1989 a hybrid S Corporation qualifies for a reduction of WHT to 5%.

The judgment in detail: Requirements of Article 10 paragraph 2 DTT

Article 10 para 2 DTT reads as follows:

> '[…] Dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the dividends are derived and **beneficially owned** by a **resident of the other Contracting State**, the tax so charged shall not exceed:
>
> a) 5 percent of the gross amount of the dividends if the **beneficial owner** is a **company** that owns directly at least 10 percent of the voting stock of the company paying the dividends […]'

Three major aspects need to be analyzed:

1. Is the S Corporation a 'company' of the other contracting state?
2. Is the S Corporation a 'resident' of the other contracting state?
3. Is the S Corporation the 'beneficial owner' of the dividends?

1) Article 3 para 1 lit. e DTT defines a company as a corporate body or an entity which is treated as a corporate body for tax purposes. The Federal Fiscal Court states that the question whether this prerequisite is fulfilled has to be assessed based on the law of the state of source (here: Germany). Since the S Corporation is treated as a non-transparent person for German tax purposes, it is a 'company' in the sense of art 10 DTT.

2) The second question was whether the S Corporation is a 'resident' in the US. According to art 4 para 1 DTT a person is a resident, if *under the laws of that state* it is liable to tax therein by reason of [its] domicile, residence, place of management or any other criterion of similar nature. Therefore, the residence is determined based on the laws of the state in which the S Corporation is domiciled (here: US). Since the S Corporation is transparent for US tax purposes, the above mentioned criteria is not fulfilled. The residence of its shareholders does not qualify as a criteria 'of similar nature'. The S Corporation thus is not a resident in the sense of art 4 para 1 DTT.

At this point, the scope of art 1 para 7 DTT becomes relevant, which reads as follows:

> 'In the case of an item of income, profit or gain **derived by or through a person** that is fiscally transparent under the laws of either Contracting State, such item **shall be considered** to be **derived by a resident** of a State **to the extent** that the item is treated for the

> purposes of the taxation law of such State as the **income**, profit or gain **of a resident**.'

(i) The 'person' through which the German sourced dividend is derived is the S Corporation.

(ii) For the purpose of US tax law, the dividends are taxed at the level of the shareholders being resident in the US.

In the view of the German Federal Fiscal Court, these two facts are sufficient to treat the S Corporation as a deemed resident. This can be substantiated by the wording of art 1 para 7 DTT, which states that the person receiving the dividend does not necessarily have to be identical to the person in whose hands the dividend is ultimately taxed in the USA. So basically art 1 para 7 DTT is the 'missing link' to consider the S Corporation a deemed resident to the extent the US taxes the dividends at the level of an actual resident. The Technical Explanations to art 1 para 7 DTT seem to have the same understanding of the provision.

In the specific situation of an S Corporation, under US tax law it is only possible to treat the S Corporation as a 'flow-through' entity if all shareholders are individuals resident in the US. Therefore, the treaty reduction has to be granted on the full amount of the dividend. Other hybrid entities (eg LLCs), of which not necessarily all of the (corporate or individual) shareholders have to be resident in the US, would be deemed resident only on a 'pro rata' basis. A treaty reduction would be granted only to the extent US-residents hold a participation in that hybrid entity.

3) The DTT itself does not define the term 'beneficial owner'. According to art 3 para 2 DTT, the laws of the state applying the DTT shall be taken into account if the context of the DTT does not require otherwise. The German Federal Fiscal Court is of the opinion that such a 'paramount context' is absent in the underlying case and therefore each state uses its (tax) law to define the beneficial owner. Germany as the state of source qualifies the S Corporation as the person who is subject to limited tax liability in Germany with respect to the dividend and therefore treats the S Corporation as the beneficial owner of the dividend.

This appears to be a bit surprising since, from a US perspective, the dividends 'flow through' the S Corporation to its shareholders and therefore the 'beneficial owners' are the individuals. The Federal Fiscal Court might well have come to the conclusion that the 'fiction' in art 1 para 7 DTT stipulates that the dividend is derived by the shareholders of the S Corporation as the dividend is, under US tax law, treated as their income. The Federal Fiscal Court, however, prefers a 'literal' understanding of the expression 'derived by a [not: the] resident …' In its opinion, art 1 para 7 DTT affects the treaty entitlement but not the income attribution, even not for treaty purposes. The judgment is in line with former jurisprudence in which it was repeatedly decided that the attribution of income to a taxpayer is normally not influenced by the double tax treaties.

In addition, the Federal Fiscal Court refers to the German-US double tax treaty 1989. According to art 4 para 1 lit. b of this treaty, the S Corporation was deemed to be a resident insofar as its shareholders are resident in the US. In addition, by protocol No 10 double tax treaty 1989, an S Corporation was expressly deemed to be the beneficial owner of German sourced dividends in comparable circumstances. In a former judgment dated 20 August 2008 (I R 39/07, Internationales Steuerrecht 2008, p 849 et seq.) the Federal Fiscal Court therefore decided that the S Corporation is generally entitled to get a reduction of German WHT to 5%. Both provisions had been abolished under the new DTT (for a discussion of the potential consequences—before the judgment—see *Schnitger*, in Endres/Jacob/Gohr/Klein, *DBA Deutschland/USA*, CH Beck, Munich 2009, art 1, m.no 74; *Schönfeld*, Internationales Steuerrecht 2007, p 274, 276). The Federal Fiscal Court expressly leaves it undecided whether or not its interpretation of art 1 para 7 DTT is shared by the US Technical Explanations and whether or not the clause risks to 'run dry' in some cases. In fact, the Federal Fiscal Court reminds the contracting states that for a different result they 'would have to clarify what they actually meant'.

Notwithstanding the technical merits of the interpretation given by the Federal Fiscal Court, the economic result of the judgment is quite surprising since from a US tax law perspective the dividends are ultimately taxed in the hands of individuals. The provision granting a reduction of WHT to 5% in the DTT, was 'designed' to reduce the risk of economic double taxation in (cross-border) groups of companies. The object and purpose of the rule does not require the application of the 5%-rate in the scenario at hand. The Federal Fiscal Court, however, felt bound by the wording of the law, as was the case in its judgment of 2008 on the former double tax treaty 1989. Just as a side note: it is interesting to see that both the US Technical Explanations on art 1 para 6 US-model tax treaty and the OECD Partnership Report (OECD, The Application of the OECD Model Tax Convention to Partnerships, Issues in International Taxation No 6 (1999) are seemingly concerned about residence in different states and therefore different applicable tax treaties when dealing with hybrid entities. But both are not dealing with different treaty entitlement (different dividend WHT rates) of the persons involved under the very same treaty (see Examples 3 through 6 of the OECD Partnership Report which relate to business profits and royalties—and in particular the last sentence of para 63 of the Partnership Report; although Examples 7 through 9 relate to dividends, there is either no treaty entitlement or entitlement under two different treaties).

III. Implications after introducing Section 50d paragraph 1 sentence 11 GITA

At present it seems unclear whether the findings of the judgment are still applicable.

A new domestic provision (s 50d para 1 sentence 11 GITA) dealing with German sourced payments to foreign hybrid entities was introduced into German tax law recently, taking effect for payments made after 30 June 2013. In an obiter dictum, the Federal Fiscal Court refers to the new provision (see also *Gosch*, BFH/PR 2014, p 33, 35).

The Federal Fiscal Authorities had already addressed the issue of relief from WHT for payments made to hybrid entities in a circular dated 16 April 2010 (*BMF-Schreiben zur Anwendung der DBA auf Personengesellschaften*). A revision of the circular is intended and may provide some more guidance regarding issues arising from the application of s 50d para 1 sentence 11 GITA.

The provision seems to state that *only* the person who is ultimately taxed *according to the tax law of the contracting state* with regard to the income received from German sources may file an application for refund of WHT in Germany.

There are mainly two questions to be analyzed. Firstly, is there a procedural and/or a material impact on the person filing an application for a WHT refund (s 50d para 1 GITA). Secondly, is there an impact on a WHT certificate of exemption; such a certificate can be applied for in advance so that no or only a reduced WHT has to be withheld by the payor (s 50d para. 2 GITA).

1) If the case of the S Corporation had been covered by the new legislation, it remains rather unclear whether the individuals who are ultimately taxed in the US with their German sourced income could have only claimed their ‘own’ reduction of WHT to 15% or if they were able to file an application ‘on behalf’ of the S Corporation leading to a reduction of WHT to 5%. If the first alternative is true, s 50d para 1 sentence 11 GITA arguably constitutes a ‘treaty override’ in relation to art 1 para 7 DTT. If the second alternative is true, s 50d para 1 sentence 11 GITA is only of a ‘procedural law nature’ and does not ‘override’ the judgment of the Federal Fiscal Court (the respective discussion in the professional literature is not yet decided).

The official reasoning for the new provision might lead to the impression that its purpose is rather to deal with the reverse situation: Germany as the source state treats the foreign entity as transparent and its partners/shareholders as the (taxable) persons who derive the income. The other contracting state treats the entity as non-transparent and therefore as the person who derives the income. In such a scenario, the provision seems to make sense since, from a German perspective, both the entity and its respective shareholders could be entitled to a reduction of WHT on their own behalf (reference is made to Examples 5 and 9 of the OECD Partnership Report). Section 50d para 1 sentence 11 GITA then avoids a 'double-claim'.

2) According to its wording the new provision is only relevant for applications for a refund of WHT. The application for a WHT certificate of exemption does not seem to be covered. A particular reason for such a different approach to refund and certificate of exemption is difficult to find. It remains to be seen how the tax administration is going to apply the new provision in this respect.

IV. EU Law

In another obiter dictum, the Federal Fiscal Court speculates whether the S Corporation may rely on the free movement of capital (art 63 TFEU) in order to be treated like a domestic corporation. Article 63 TFEU is the only fundamental freedom in the EU requiring member states to avoid discriminatory treatment even in relation to non-member states (so-called 'third countries'). In a pure domestic situation the WHT can be credited against the corporate income tax at the level of the corporate shareholder resulting in an effective tax rate on the dividends of 0.79% (5% of the dividend*15% corporate tax rate plus 5.5% solidarity surcharge thereon).

In a cross-border case, the WHT (after relief to match the tax treaty rate) is 'final' according to s 32 para 1 no 2 Corporate Income Tax Act (CITA). The Court of Justice of the European Union (CJEU) in *European Commission v Germany* (Case C-284/09) [2011] STC 2392, [2011] ECR I-9879 found this incompatible with art 63 TFEU. However, the decision only relates to intra EU shareholdings.

It is currently not entirely clear whether a third country resident can rely on the free movement of capital with regard to WHT. Some authors take the view that the CJEU might differentiate between a third country *outbound* case as compared to an *inbound* 'market access' situation. On the other hand, one can well argue that provisions in the tax law regarding the taxation of dividends do not relate to requirements for a 'market access' (see *Test Claimants in the FII Group Litigation v Revenue and Customs Comrs* (Case C-35/11) [2013] STC 612, para 100; *Itelcar*, C-282/12, 3 October 2013, para 24; Opinion of AG Mengozzi, *Emerging Markets*, C-190/12, 6 November 2013, para 19; Opinion of AG Villalon, *Kronos*, C-47/12, 7 November 2013, para 61 et seq).

Yet, the Federal Fiscal Court did not need to refer the case to the CJEU. According to the Federal Fiscal Court's jurisprudence, such EU claims cannot be filed with the Federal Central Tax Office but only with the competent (local) tax office, hence in a different procedure. In addition, the plaintiff had not claimed for a further reduction of the WHT.

V. Tax planning opportunities

In German tax literature, it is discussed whether individuals resident in the US can achieve a reduction of German WHT to 5% (or nowadays even 0%) by simply interposing a hybrid S Corporation when investing in a German-resident corporation. Besides the open issues generated by the new provision in s 50d para 1 sentence 11 GITA (see above), the interposed S Corporation should have to pass the LOB-clause of art 28 DTT when applying for a reduction of WHT. Under other German treaties which provide for similar provisions as art 1 para 7 DTT the anti-treaty shopping clause in s 50d para 3 GITA has to be taken into consideration. Either of the aforementioned provisions could lead to a reduction of the WHT to only 15%.

VI. Conclusion

The judgment of the German Federal Fiscal Court is the first one dealing with the scope of art 1 para 7 of the German-US DTT. Since both Germany (with Bulgaria, Mexico and the Netherlands (presumably applicable from 1 January 2015)) and the US have concluded a number of double tax treaties containing similar or identical provisions, it will be interesting to observe whether other courts will adopt or reject the interpretation of the German Federal Fiscal Court. From a German perspective some questions remain, ie the application of the new s 50d para 1 sentence 11 GITA, the application of the LOB-clause in art 28 German-US DTT and the anti-treaty shopping provision in s 50d para 3 GITA, EU-law issues and, on a more general point, the relevance of the Partnership Report for the interpretation of Germany's double tax treaties.

Juergen Luedicke

26 June 2013. The following judgment was delivered.

JUDGMENT

LEITSÄTZE

1. Für die Beurteilung, ob eine 'Gesellschaft' i.S. des Art. 3 Abs. 1 Buchst. e DBA-USA 1989/2008 vorliegt, ist die Rechtsordnung des Quellenstaats maßgeblich. Die Ausübung des steuerlichen Wahlrechts, in den USA als sog. S-Corporation nicht mit der dortigen Corporate Tax besteuert zu werden, ändert aus deutscher Sicht nichts an der Einordnung als juristische Person (Bestätigung des Senatsurteils vom 20. August 2008 I R 39/07, BFHE 222, 509, BStBl II 2009, 234).