Taiwan: New tax agreement with Germany in force

The tax treaty between Taiwan and Germany, which was signed in 2011, entered into force on 7 November 2012 and will apply to income derived on or after 1 January 2013. Germany is Taiwan’s largest European trade partner and the largest economy in Europe and the treaty is expected to boost future trade and investment activities between the two countries. This is Taiwan’s 24th tax treaty, while Taiwan was one of the jurisdictions missing from Germany’s extensive tax treaty network.

This article looks at the key features of the treaty from both Taiwan and Germany tax perspectives.

Permanent establishment

The treaty includes the general OECD definition of a permanent establishment (PE). However, unlike the OECD model, it provides that a building site, construction, assembly or installation project will constitute a PE if it lasts more than six months, a much stricter threshold than the 12 months provided in the OECD model treaty. On the other hand, an enterprise providing services, including consultancy services, will create a PE in the other jurisdiction only if the enterprise, through employees or other personnel engaged for the same or a connected project, provides services for a period or periods exceeding six months in the aggregate within any 12-month period. This services PE article provides an opportunity for companies in either jurisdiction to benefit from the exemption under the business profits article.

Dividends

The maximum withholding tax on dividends paid to a resident of the other country is 10% and there is no participation requirement to enjoy this preferential rate. The 10% rate is a significant reduction in the 20% withholding tax under Taiwan’s domestic law.

On German side, the withholding tax rate, which under German domestic law, including the solidarity surcharge, is 26.375% (or 15.825% for dividends paid to a nonresident corporation in a non-treaty/non-EU directive situation where the corporation has a certain level of substance and application is made to the Federal Central Tax Office) can be reduced to 10%. However, the rate will be 15% where the dividends are distributed by a “real estate investment company,” as defined in the German Act on Real Estate Stock Corporations with Listed Shares.

The treaty also contains a most favored nation clause. If Taiwan subsequently concludes a tax treaty with another OECD country that reduces the withholding tax rate on dividends below 10%, that lower rate will apply under the treaty with Germany.

Interest

The maximum withholding tax rate on interest paid to a resident of the other country is 10%, which should encourage financing and investing activities between Taiwan and Germany. On the Taiwan side, the 10% cap is helpful because it is lower than the 15% or 20% withholding tax under domestic law levied on interest paid to nonresidents, depending on the type of debt instrument. A 15% rate will apply where the interest is paid by a real estate investment trust or a real estate asset trust governed by the provisions of the Taiwan Real Estate Securitization Act.

Germany generally does not levy withholding tax on German-source interest under domestic law, except on interest on deposits with German banks/financial institutions (25%) and certain hybrid instruments, for example, typical silent partnerships, convertible bonds and certain profit participating loans where a German resident company is the debtor. In these cases, the withholding tax is 26.375%, including the solidarity surcharge. The treaty reduces the rate to 10%.

Royalties

The maximum withholding tax on royalties paid to a resident of the other country is 10%. This is a significant reduction in the 30% royalty withholding tax under Taiwan’s domestic law and the 15.825% tax, including the solidarity surcharge, on the German side.
Procedural rules for taxation at source

The treaty contains procedural rules for the withholding of tax at source, requiring tax to be withheld at the domestic rate, with the possibility of claiming a refund (for the difference between the tax at the domestic rate and the tax at the treaty rate) by the end of the fourth year following the calendar year in which the tax was withheld on the dividend, interest, royalty or other items of income. However, if a contracting state has procedures for a taxpayer to obtain benefits under the treaty, the reduced tax rate or exemption will apply according to those procedures.

Under Taiwan’s Regulations Governing the Application of Agreements for the Avoidance of Double Taxation with Respect to Taxes on Income, the withholding tax rates on dividends, interest, royalties or other items of income can be reduced to the relevant treaty rate, provided a tax residency certificate and beneficial ownership letter are presented. If the documents are not sufficient at the time the income is paid and tax withheld, the taxpayer can submit a refund application within five years from the date of the withholding (i.e. the above four-year deadline does not apply).

From a German tax perspective, the German payer company has to withhold tax according to the German domestic tax law and the recipient parent company may apply for a reduction to the lower rate of withholding tax under the treaty if certain substance requirements are met. A refund is possible until the end of the fourth year following the calendar year in which the tax was withheld. However, the payer company also can apply the reduced rate of withholding tax under the treaty if the parent company obtained an exemption certificate from the German Federal Tax Office before the payment was made. The exemption certificate is valid for a maximum period of three years.

Other provisions

To be in accordance with German domestic law, the protocol to the treaty and the treaty itself contain clarifications and regulations to the articles that differ from provisions in Taiwan’s other treaties. The following are the most relevant:

- From Germany’s side, dividends and interest may be taxed in the country in which the income arises when the dividends and interest are derived from rights or debt claims carrying a right to participate in profits, including income derived by a silent partner from his participation as such, or from a loan with an interest rate linked to profits of the borrower or from “profit-sharing bonds” as defined under domestic law, and provided the dividends and interest are deductible in calculating profits. This measure does not apply to Taiwan-source dividends or interest because Taiwan does not have any domestic rules regulating these situations.
- To prevent individuals who cease to be German tax resident from avoiding expatriation tax by using the Taiwan-Germany treaty, the capital gains article provides that if an individual was a resident of Germany for at least five years and subsequently becomes a resident of Taiwan, the German tax authorities can tax the capital appreciation of shares in a company resident in Germany that are attributable to the individual’s period of residence in Germany. As Taiwan does not have an expatriation tax, this article will not apply to Taiwan.

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