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Client Alert

Tax Practice Group

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Investment in real estate: France-German double tax treaty changes

On 31 March 2015, the Governments of France and Germany signed an amendment to the France-German treaty dated (the "Treaty"), which will have an impact in the future for certain investments in real estate. For France, this amendment follows the amendment to France-Luxembourg signed on 5 September 2014 which also impacts foreign investments in French real estate. The same applies for the Germany which also entered into an amended Treaty with Luxembourg on 23. April 2012 applying most of the amendments as from 1 January 2014 or 1 January 2015 (as regards information exchange for interest income).

There are several changes brought to the Treaty on the basis of the OECD model, but as far as real investments are concerned, it introduces a new rule for (i) gains from the sale of shares of an entity (independent from the legal from and seat of the entity (local or abroad) that predominantly holds real estate assets, and (ii) dividend distributions by REIT (SIIC in France) and OPCI.

This protocol adds a new paragraph 4 to Article 7 of the Treaty specific to the disposal of shares of companies said to be "mainly real estate", on the basis of the OECD model. The new provision provides that "gains derived by a resident of a Contracting State from the alienation of shares, units or other rights deriving directly or indirectly more than 50 per cent of their value of real estate situated in a Contracting State shall be taxable only in that State." An exception is only provided for immovable property deployed within a business enterprise such as a mine or a hotel.

Under the current Treaty, article 7 (1) provides that "income derived from the alienation of a joint-stock company shall be taxable only in the contracting state of which the alienator is a resident". Gain from the sale of shares in a French joint-stock with predominantly French real estate are not taxable in France. In Germany, such gain is eligible to the parent-subsidiary regime.

Regarding dividend in relation to REIT (SIIC in France) and OPCI distributions, the treaty introduces a new paragraph 10 to Article 9, using exactly the same wording as introduced in the France-United-Kingdom treaty dated 19 June 2008 following the OECD recommendations by not denying disapplying the 15 per cent and the nil withholding tax rates to dividends "paid out of income or gains derived from immovable property within the meaning of article 3 by an investment vehicle (a) which distributes most of this income

For more information, contact:

Aurélia de Viry
+33 1 73 00 39 02
adviry@kslaw.com

Axel Schilder
+49 257 811 300
aschilder@kslaw.com

King & Spalding
Paris
12 Cours Albert 1er
75008 Paris
France
Tel: +33 1 7300 3900
Fax: +33 1 7300 3959

Frankfurt
TaunusTurm
Taunustor 1
60310 Frankfurt am Main
Germany
Tel: +49 69 257 811 000
Fax: +49 69 257 811 100

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annually; and (b) whose income from such immovable property is exempted from tax" to a beneficial owner holding 10 per cent or more of the capital of the paying vehicle. Thus the source State may tax such dividends at the rate applicable under its domestic law, i.e. 30% in France or 25% (flat tax – *Abgeltungssteuer*) in Germany (plus 5,5% surcharge thereon) for individuals or subject to application of the tax exemption of Sec. 8b of the German Corporate Income Tax Code for corporations holding at least 10% in the paying vehicle.

A similar clause was not introduced in the amendment to the France-Luxembourg treaty dated 5 September 2014, but the press release published by the Luxembourg Ministry of France indicates that France and Luxembourg will continue working on the update of the Treaty on the basis of the OECD model like it has been introduced in the Treaty between Germany and Luxembourg already. Future amendments could therefore concern distributions of OPCI.

The Amendment will have enter into force on the first day following the day of the last notification of ratification is received by the States and will apply from the beginning of the calendar year following its ratification by both States. Thus, if each State ratifies and notifies the amendment prior to 31 December 2015, the new provisions will apply as from 1st January 2016.

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