Client Alert

January 2026

Germany: No Treaty Relief for Dividends of DREs?

In brief

The Federal Central Tax Office (FCTO) appears to have adopted a new administrative practice:

It has been reported that withholding tax exemption certificates under Section 50c German Income Tax Act (EStG) are denied where the dividend distributing corporation in Germany is held by a US parent and is treated as a disregarded entity (DRE) for US tax purposes.

If these reports are accurate, this would represent a significant departure from longstanding practice. In many structures, the impact may be severe:

- Dividend withholding tax (26.375%) may become due on dividend distributions, including deemed dividend distributions following transfer pricing adjustments.
- Royalty payments from German DREs may also be affected, with the domestic rate being 15.825% and, accordingly.
- Restructuring needs could arise.

Crucially, **this new administrative view has no apparent treaty-law or statutory basis**. Our analysis suggests that **treaty benefits must still be granted in DRE-constellations,** as further explained below.

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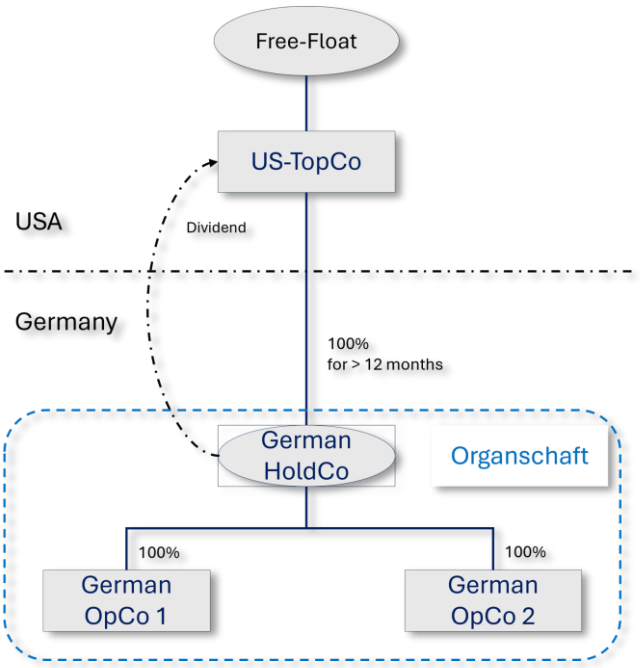
In more detail

1. Case study

Since 2018, B-Group, a US multinational, has owned a German holding company ("**German HoldCo**"), which is the income-tax parent of two German operating subsidiaries ("**German OpCo 1**" and "**German OpCo 2**"). The main share class of B-Group's ultimate parent, US TopCo, is listed on the New York Stock Exchange (NYSE). From a US perspective, **German HoldCo is a disregarded entity** under the check-the-box rules. From a German perspective, it is a fully taxable corporation. Historically, the FCTO has issued 0% exemption certificates under Art. 10 (3) Germany-US Double Tax Treaty (DTT). For 2025, however, the FCTO unexpectedly denied a follow-up certificate, arguing that the US shareholder cannot claim treaty benefits when the German distributing entity is a DRE.

Structure



2. Analysis

2.1 Procedural framework (Section 50c EStG)

Dividend distributions from German HoldCo to US TopCo are, as a rule, subject to withholding tax at the domestic rate of 26.375%. Under Section 50c (2) EStG, the German payor may refrain from withholding only upon issuance of a valid **exemption certificate** confirming that the Germany-US DTT eliminates German tax on the dividend.

2.2 Treaty entitlement

2.2.1 Previous administrative practice

For decades, the FCTO has not examined the **foreign** tax classification of the **German** corporation that makes the dividend distribution. Forms, guidance and questionnaires under Section 50c/50d EStG likewise contained no such requirement. Exemption certificates were thus regularly granted in DRE situations.

2.2.2 Apparent new FCTO position

Recent reports indicate that the FCTO has begun refusing withholding tax exemption certificates in cases where the German distributing company is regarded as fiscally transparent from the perspective of the shareholder's residence state. This shift of administrative practice lacks any discernible statutory or treaty basis and mirrors a broader pattern of contentious administrative reinterpretations (e.g., the "register cases"). Such unpredictability in administrative practice undermines investor confidence and places a strain on relationships with key treaty partners.

2.2.3 Discussion

The FCTO's restrictive interpretation is **not persuasive**:

- **Art. 10 (3) (a) (aa) Germany-US DTT** applies: US TopCo is a US tax resident corporation and holds 100% of the voting rights in German HoldCo for more than twelve months.
- **The German classification governs** whether German HoldCo is a "company" and whether its payments qualify as "dividends." The US classification remains out of consideration.
- **Art. 1 (7) Germany-US DTT does not apply**, because the income is not "derived by or through" a hybrid entity.

2.2.3.1 Analysis of Article 10 (3) Germany-US DTT

Art. 10 (3) (a) (aa) Germany-US DTT provides for a withholding tax rate of 0% if a company resident in one contracting state receives dividends as a beneficial owner from a corporation resident in the other contracting state and has held at least 80% of the voting rights in the distributing company for at least twelve months.

US TopCo is a company based in the United States within the meaning of Art. 4 (1) Germany-US DTT. It receives dividends from a corporation based in Germany, German HoldCo, which is subject to unlimited tax liability due to its statutory seat and place of management being in Germany.

The US tax classification of German HoldCo as a disregarded entity is irrelevant from a German perspective. The tax classification of German HoldCo as a "company" within the meaning of the Germany-US DTT is determined solely by the view of the source state Germany as the state applying the treaty; the foreign classification is not adopted (no linking of classifications).

The term "dividend" in Article 10 (3) of the Germany-US DTT is defined in accordance with Article 10 (5) of the Germany-US DTT, with reference to the law of the applying state. Under German tax law, distributions made by German HoldCo are dividends that are attributable exclusively to US TopCo under both national law and treaty law (Section 20(5) EStG; see BFH 26.6.13, I R 48/12).

The special requirements in Art. 10 (3) (a) (aa) Germany-US DTT for 100% are met. US TopCo is a listed company within the meaning of Art. 28 (2) (c) (aa) DBA-DTA, so that it is entitled to all treaty benefits. Neither Art. 10 (3) nor Art. 28 (2) of the Germany-US DTT contains a subject-to-tax clause.

2.2.3.2 Article 1 (7) Germany-US DTT

Art. 1 (7) Germany-US DTT does not apply.

The provision covers situations where an item of income, profit or gain is derived by or through a person that is fiscally transparent under the laws of either Contracting State. In such case, the 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.

In the case at hand, US TopCo receives the dividend income directly itself. It is a taxable person and a tax resident of the US for the purposes of the Germany-US DTT from both a German and a US perspective. The fact that German HoldCo is treated as a disregarded entity for US tax purposes is irrelevant in this respect (see Wassermeyer/Linn, 171. EL September 2025, Germany-US DTT Art. 10 Rn. 78). The dividends are neither derived by nor through German HoldCo but are distributed by it. Therefore, Art. 1 (7) Germany-US DTT does not apply in this case.

2.3 Domestic relief restrictions

US TopCo's entitlement to treaty relief should also not be restricted under the provisions of German domestic law, specifically, Section 50d (3) EStG, Section 50d (14) EStG or Section 50d (11a) EStG.

2.3.1 Section 50d (3) sentence 1 EStG (German anti-treaty shopping rule)

Section 50d (3) EStG is not applicable pursuant to its sentence 2, as the main class of shares of US TopCo is regularly and substantially traded on the New York Stock Exchange, a recognized stock exchange.

2.3.2 Section 50d (3) sentence 1 EStG (German CTB election)

Section 50d (14) EStG is not relevant, either, as it exclusively concerns dividends from partnerships that elect to be treated as a corporation under the “German Check-the-Box Election Rule” in Section 1a German Corporation Tax Act (KStG).

2.3.3 Section 50d (11a) EStG (hybrid mismatch rule)

Furthermore, Section 50d (11a) EStG does also not apply.

Section 50d (11a) EStG goes back to Section 50d (1) sentence 11 EStG (old version). According to the legislator’s explanatory memorandum, Section 50d (1) sentence 11 EStG (old version) was intended to prevent "treaty-based refund claims from coming to nothing in the event of different qualifications of the creditor (hybrid mismacthes) due to diverging income attributions" (cf. BT-Drs. 17/13033, 72). Accordingly, the provision was intended as a favorable regulation.

In tax literature, Section 50d (11a) EStG is generally viewed very critically (cf. Zuber in: Littmann/Bitz/Pust, Section 50d EStG margin number 212; Herrmann/Heuer/Raupach, Section 50d EStG). In particular, it is controversial whether the provision has only procedural or also substantive legal effect. However, irrespective of whether Section 50d (11a) EStG is viewed as a procedural or substantive rule, its requirements are not met in the present case.

The provision presupposes an attribution mismatch caused by the hybrid nature of the dividend recipient. No such mismatch exists here: both contracting treaty states consider US TopCo as an opaque (taxable) entity (i.e., there is no hypbrid mismatch). The US non-taxation of the dividend results solely from the check-the-box election of German HoldCo. Thus, there is no attribution divergence ("To whom is the income attributable?"), but rather an income asymmetry due to qualification ("Is there income at all?"). Such constellations, however, are not covered by Section 50d (11a) EStG – neither according to its wording nor its purpose, which targets cases involving different tax qualifications of the recipient of the income.

But even assuming Section 50d (11a) EStG were applicable in the case at hand, it would in our view not change the outcome. The rule is not intended as a treaty override. Moreover, it is expressly tied to refund claims, which is consistent with its origin in the former Section 50d (1) sentence 11 EStG (old version), which governed refund procedures only. An analogous application of Section 50d (11a) EStG in the exemption procedure is not possible, either. Such analogous application would be to the detriment of the taxpayer and would be incompatible with the rule of law in Article 20 (3) of German Constitution. Moreover, no unintended legislative gap exists, which is a precondition for an analogous application.

2.4 Conclusion

In summary, the dividend distribution by German HoldCo to its US-based parent company is subject to full exemption from German withholding tax under Art. 10 (3) (a) (aa) DBA-US. The refusal to issue an exemption certificate solely on the basis of the US tax classification of German HoldCo as a DRE is not legally tenable.

Recommended actions

- Continue applying for 0% withholding relief and contest any denials.
- Suspend or defer payments where appropriate (e.g., royalties) to prevent unnecessary cash tax leakage.
- Monitor developments closely and coordinate with US tax teams to assess wider implications.

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