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Recent Developments in International Taxation
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Germany[1]

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[1] This report includes selected developments up to 17 May 2019.

I. Recent highlights

1. Legislation

Indirect investments in real estate in Germany – Extended limited tax liability: The limited tax liability of non-resident persons with the profits derived of the sale of shares in real estate-rich corporations has been extended. Under the new law, the sale of shares in corporations that are not tax residents in Germany is subject to tax in Germany if *inter alia* the share value to more than 50% consists of real estate located in Germany. Pursuant to many double taxation treaties, Germany already had the right to tax such profits. However, it could not exercise its taxation right because of the gap in domestic law that now has been closed.

Additionally, the limited tax liability on the non-resident person's business income generated from the renting and the sale of real estate located in Germany has been extended. Under the new law, changes in the value of assets that have an economic link to real estate are subject to German taxation. According to the legislator, profits derived from a waiver of a (shareholder) loan granted to fund the acquisition of the real estate will be subject to tax.

Loss forfeiture in the case of transfer of shares: Sec. 8c para. 1 *sent.* 1 German Corporate Income Tax Act ("**CITA**") stipulated the pro rata forfeiture of losses and loss carried forwards if between 25% and 50% of the shares or voting rights were transferred within a five year period. Following a decision of the German Federal Constitutional Court ("**BVerfG**") which held that this restriction of loss deduction is unconstitutional, the legislator decided to abolish Sec. 8c para. 1 *sent. 1* CITA retroactively. Therefore, the transfer of shares after 31 December 2007 does not result in a pro rata loss forfeiture.[2]

Taxation of corporate restructurings: Following the decision by the Federal Fiscal Court ("**BFH**") that the tax exemption for restructuring profits – granted by the tax authorities based on the so-called Restructuring Decree by the Federal Ministry of Finance – was an unlawful administrative act, the legislator introduced Sec. 3a German Income Tax Act ("**ITA**"), which stipulates the tax exemption for restructuring profits subject to certain criteria. After the European Commission had issued a comfort letter stating that no formal notification was required under the EU State Aid rules, Sec. 3a ITA became effective.[3]

In addition to the restrictions of Sec. 8c CITA, the European Court of Justice ("**ECJ**") held that the escape clause for restructurings – so-called "Restructuring Clause" – does not qualify as an illegal EU State Aid. Therefore, the Restructuring Clause applies to share transfers effected after 31 December 2007.

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[2] Sec. 8c CITA has also been challenged in its pre-2016 version to the extent it stipulates the forfeiture of the entire loss carried forwards if more than 50% of the shares or the voting rights are transferred within a five year period. The case is still pending.

[3] The new law applies to restructuring profits realized after 8 February 2017. In addition, upon application, the exemption should apply to debt waivers made on or before 8 February 2017.

Value Added Tax - Introduction of filing obligations and secondary liability for operators of an electronic market place: With effect of 1 January 2019, operators of electronic market places are obligated to provide information on potentially taxable supplies in Germany rendered by users of their platform. If the operator fails to comply, the operator can be held secondarily liable for unreported value added tax ("**VAT**") triggered by supplies provided over its platform. The new rules are supposed to prevent a shortfall of VAT for supplies made via the Internet.

Brexit: After the United Kingdom ("**UK**") exit the European Union ("**EU**"), the UK will become a third country for tax purposes. The third country status may have a negative impact on taxpayers that are connected to the UK. The German Parliament passed an act to regulate tax implications of Brexit ("**Brexit Act**", *Brexit-Steuerbegleitgesetz*) in order to mitigate certain legal consequences that solely arise from the fact that the UK becomes a third country. It will apply to cases, which were implemented prior to Brexit.

2. Court decisions

Anti-treaty/-directive shopping rule on the relief of withholding tax violates EU law: After the ECJ in 2017 held that the pre-2012 version of Germany's anti-treaty shopping rule in Sec. 50d para. 3 ITA violates the EU Parent-Subsidiary Directive, as well as the freedom of establishment principle of Article 49 of the Treaty on the Functioning of the EU, the ECJ confirmed this view for the post-2012 version. The tax authorities continue to apply Sec. 50d para. 3 ITA in third country cases. However, a new anti-treaty shopping rule is reportedly to be introduced.

Deduction of dividend payments of foreign companies under the German Trade Tax Act: On 20 September 2018, the ECJ ruled that the "activity clause" in the German Trade Tax Act ("**TTA**") that applies to dividends distributed by third country companies violates the EU principle of free movement of capital. Under the TTA, dividends distributed by third country companies are only tax exempt if the third country company derives "active" income. By decree dated 25 January 2019, the tax authorities decided that the "activity clause" will not be applied going forward. Pursuant to the recently published draft bill of the "Act for the further tax support of e-mobility and for the amendment of additional tax provisions" ("**Finance Act 2019**"), the TTA will no longer distinguish between dividends distributed by third country companies and those distributed by an EU company.

II. Future developments

Amendments to the German Real Estate Transfer Tax ("RETT"): The draft bill of the Finance Act 2019 includes long-awaited amendments to the RETT Act. Pursuant to the current RETT Act, the sale of shares in a company holding German real estate generally triggers RETT if 95% of shares are transferred or consolidated. In addition, for partnerships holding German real estate, the direct or indirect transfer of at least 95% of their interests to new partners within a five year holding period triggers RETT. For a transfer between a partnership and its partners, there are several tax exemptions that require a five year holding period. Under the draft bill,

the following main measures will be implemented in order to tackle the use of share deals to avoid RETT: (i) The threshold of 95% will be lowered to 90%. (ii) Generally, the holding periods of five years will be extended to ten years. (iii) Going forward the direct or indirect transfer of at least 90% of shares in a corporation holding real estate to new shareholders within a ten year period will be subject to RETT.

Research and development incentives: Recently, a draft bill was published to introduce a R&D tax allowance scheme for projects in basic research, industrial research, and experimental development. The aim is to enhance Germany's competitiveness as a business location and to promote the attractiveness of Germany globally as a business location for new businesses and investments. The draft bill includes measures that would introduce a tax-free allowance of 25% for qualified R&D expenses up to two million euros per year.

Multilateral Instrument ("**MLI**"): Germany signed the MLI developed by the OECD. Following the ratification of the German Parliament in the course of the current year it is expected that the changes to the double tax treaties will become effective from 2020.

"**ATAD I**": The EU Anti Tax Avoidance Directive known as "ATAD I" includes regulations on controlled foreign companies. Therefore, the German controlled foreign company regime will be amended. The scope of the amendments is yet to be seen, as no draft bill has been published so far.

Taxation of the digital economy: On 23 January 2019, the OECD and the G20 published initial proposals for solutions in the form of a "Policy Note" for the taxation of the digital economy in times of ever-increasing internationalisation. The aim is to split the tax base between source countries and countries where a company has its seat.

Mandatory reporting obligations: On 30 January 2019, the German Federal Ministry of Finance sent a draft bill to the federal ministries in order to adopt the EU Directive 2018/822/EU of 25 May 2018. It introduces mandatory reporting obligations for taxpayers and intermediaries who design or promote tax planning schemes. They will have to report cross-border arrangements to the tax authorities, which – subject to certain criteria – are considered as tax aggressive. However, the draft bill goes beyond the EU Directive since it includes mandatory disclosure rules for certain domestic tax arrangements.

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