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Recent Developments in International Taxation

Germany

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Draft amendment of the Foreign Tax Act

Overview

Based on the latest developments regarding base erosion and profit shifting (BEPS) by the Organisation for Economic Co-operation and Development (OECD) and Anti-Tax Avoidance Directive (ATAD), a new draft law was published in December 2019 in respect of the German Foreign Tax Act (FTA). In general, the draft law includes the following issues:

- amended/new transfer pricing (TP) rules (eg, best method approach);
- new TP rules for intangibles;
- new TP rules for financing (inbound only);
- amended TP rules for price adjustment clauses;
- amended TP documentation rules;
- new rules for advance pricing agreement (APA) proceedings; and
- new controlled foreign corporation (CFC) rules.

Yet, it is unclear when the respective tax rules will become effective.

Amendments to the TP rules

In particular, the TP rules shall be amended. For instance, the legislator intends to introduce the following new TP rules concerning the deduction of interest expenses from intercompany financing:

- Income-decreasing expenses resulting from cross-border financing (eg, interest-bearing shareholder loans) are set at arm’s length only if both of the following conditions are met: (1) the taxpayer is able to demonstrate that it could have serviced the debt for the entire term from the outset, and financing is economically necessary and used for business purposes; and (2) the interest rate to be paid by the taxpayer does not exceed the interest rate at which the entire multinational group as such could obtain funding from third parties, unless the taxpayer provides evidence that another value is in line with the arm's length principle.
- If a company acts as a financing broker for another company within a multinational group or if funding will be merely passed through by a company to another company within a multinational group, these intercompany transactions are deemed as routine services. In this case, the interest is limited to the risk-free interest rate, which shall correspond to the interest rate for government bonds of the highest credit rating with adequate maturities.

- In addition, the revenue threshold for the requirement to prepare a master file (TP documentation) will be halved to €50m. In addition, that master file must be filed electronically and in a very timely manner.

CFC rules

The German CFC rules shall be amended as well. In general, the main amendments shall, inter alia, refer to the definition of controlling shareholdings, the requirement of substance and the catalogue of passive income.

Thus, a controlling shareholding shall be met provided that: (1) the shareholding covers the majority of voting rights; (2) the majority of shares in the registered capital ('Nennkapital') are allocated in/directly to the shareholder; or (3) the shareholder has ownership in/directly has the right of participation in more than half of the revenue/liquidation proceeds.

In general, the CFC rules shall apply in the case of derived passive income, which shall be amended merely in parts, for example:

- income derived from financial institutions and insurance companies shall be regarded as passive income, provided it consists of more than one-third of business operations with related parties; and
- income derived from trade and services shall be regarded as passive income in the case of trade and services provided with the participation of shareholders and their related parties who are subject to taxation in Germany or a Member State of the European Union or European Economic Area.

Profit distributions and capital gains from the sale of shares shall still be regarded as active income.

In addition, the requirement of substance shall be amended in accordance with the guidelines of ATAD, and the provision of substantial economic activity shall be regarded as sufficient. Thus, the provision of such substantial economic activity shall be resourced with personnel, as well as objective substance.

Exit taxation (section 6 of the Draft Foreign Tax Act (FTA))

Exit taxation according to section 6 of the Draft FTA applies in the case of taking up residence abroad after being subject to unlimited income tax liability for at least ten years and holding shares in a German corporation that exceeds one per cent of the company's capital. The German rules for exit taxation shall be amended as follows:

- the required period of unlimited income tax liability prior to expatriation shall be decreased to unlimited income tax liability for seven out of 12 years prior to expatriation;
- upon request and by way of security, the deferred payment of exit tax shall be available for seven years; and
- in the case of a return to Germany, and again, unlimited income tax liability within five years after expatriation, exit taxation shall not apply. However, a tax-neutral return shall only apply, provided that: (1) the shareholding has not been sold or transferred to business property in the meantime; (2) profit distributions have not exceeded the threshold of 25 per cent of the shares' market value; and (3) the German right of taxation regarding the shareholding equals or exceeds the previous right of taxation.

Draft section 4k of the Income Tax Act (ITA) – Deduction of business expenses in the case of tax mismatches

The draft law regarding the deduction of business expenses in the case of tax mismatches shall implement the guidelines according to sections 9 and 9b of the ATAD into German law and section 4k of the ITA. As such, business expenses shall not be deductible in the following cases:

- the income corresponding to the expenses is not subject to taxation or is taxed at a lower tax rate than under German law (deduction/non-inclusion mismatch);
- double deduction of expenses under German and foreign tax law without matching taxation of income (double-deduction mismatch); and
- the income resulting directly or indirectly from such expenses is offset by expenses whose deduction from the creditor, an additional creditor or other party under this paragraph or any of the preceding paragraphs would have been refused if the creditor, additional creditor or other party had been subject to unlimited domestic tax liability (imported tax mismatch).

Disclosure obligations

In accordance with EU Directive 2011/16/EU ('DAC 6'), international tax structures, as well as their amendments, are notifiable to the German tax authorities within 30 days as of 1 July 2020 if they relate to income tax, corporate income tax (CIT), trade tax (TT) or inheritance tax and have been established since June 2018. Tax structures established since June 2018 have to be disclosed as well, but an extended deadline of 31 August 2020 applies. Please note, that the respective deadlines could be delayed due to the Covid-19 pandemic, but this is unclear.

VAT and duties are not covered (section 138d of the General Tax Code (GTC)). Intermediaries (eg, lawyers and tax advisers) who design, set up, organise, provide or manage the international tax structures are obliged to disclose these structures to the Federal Central Tax Office

(Bundeszentralamt für Steuern). The violation of disclosure obligations can be fined up to €25,000.

The disclosure obligations only relate to international tax structures, and if the involved companies/entities are, inter alia, tax resident in at least two states, constitute permanent establishments in other countries or establish cross-border business activities. For the evaluation of this, a catalogue of characteristics apply that can be divided into five categories: general characteristics (eg, non-disclosure agreements), specific characteristics (eg, acquisition of loss-generating companies), cross-border payments (eg, cross-border intercompany payments), tax transparency (eg, reporting obligations), TP agreements (eg, use of unilateral safe harbour rules). The application of the disclosure obligations for tax structures within the meaning of section 138e (1) of the GTC (eg, meeting the category of general characteristics, specific characteristics and cross-border payments) requires that the main benefit of these international tax structures are tax benefits. In general, a tax benefit relates to tax refunds, reduction of tax payments or prevention of the constitution of tax liabilities; or deferral of tax liabilities to other or future tax periods.

Draft amendment of the Real Estate Transfer Tax Act

The German Real Estate Transfer Act (RETTA) will also be amended. The main amendment refers to the transfer of shareholdings and interests in real estate rich companies. For the time being, RETT-able events are linked to certain thresholds and a period under review. Thus, under current law, the direct or indirect transfer of 95 per cent or more of the interests in a real estate holding partnership to new partners within five years triggers RETT (section1 (2a) of the RETTA). Furthermore, if, from an economic point of view, one single person directly or indirectly holds 95 per cent or more of the interests in a partnership as a result of a transaction or measure, RETT will be triggered, even if less than 95 per cent is transferred within this transaction (sections 1 (3) and (3a) of the RETTA).

However, according to the latest draft dated 31 July 2019, RETTA shall be amended as follows:

- in general, the relevant participation thresholds shall probably be reduced from 95 per cent to 90 per cent;
- the extension of the period under review from five years to ten years;
- the implementation of an additional RETT-event for corporations owning real estate property (section 1 (2b) of the Draft RETTA);
- the application of a substitutional assessment base for specific acts of transformation;
- the abolition of the limit for the late filing penalty in terms of section 152 (10) of the General Tax Code (section 19 (6) of the Draft RETTA); and

- the application of the amended RETTA to acquisitions as of 1 January 2020; parts of the effective regulations shall also be applicable in the future.

The implementation of a new regulation regarding real estate rich corporations according to section 1 (2b) of the Draft RETTA shall apply to the direct or indirect transfer of more than 90 per cent of the shares in a company owning real estate property to new shareholders (one or more) within a period of ten years. As a consequence of such a RETT-able transfer of shares to new shareholder(s), the value of real estate property shall be subject to taxation, and the company shall be liable for RETT. The application of section 1 (2b) of the Draft RETTA and the grandfathering clause for ongoing transactions should only apply to the acquisition of shares after 31 December 2019 (section 23 (17) of the Draft RETTA); however, transfers before 1 January 2020 may be considered. The tax consequences in terms of section 1 (2b) of the Draft RETTA should not apply provided that the disposition agreement is made within one year prior to the insertion of the draft to the Federal Parliament (Bundestag) and the agreement is executed within one year after that (section 23 (23) of the Draft RETTA).

Tax measures due to the Covid-19 pandemic

Due to the Covid-19 pandemic, the German administration has passed tax measures to relieve the negative impact of the pandemic on companies. With the help of an immediate action programme, the liquidity status of companies should be improved and should encourage recovery. Thus, the following measures have been agreed upon:

- relieved approval of tax deferrals;
- relieved adjustments of tax prepayments; and
- waiving of late payment fines and actions of enforcement until 31 December 2020, provided the taxpayer is affected directly by Covid-19.

In addition, the following measures have been agreed upon by the German Government recently and shall be passed soon:

- decrease of the VAT rate from 19 per cent to 16 per cent, and seven per cent to five per cent for special goods (eg, food), as of 1 July 2020 until 31 December 2020;
- declining balance depreciation for acquisitions in fiscal years (FYs) 2020 and 2021 up to 25 per cent of the tax book value;
- increase of the maximum amount of loss carry back to €5m for FYs 2020 and 2021;
- increase of the tax allowance for financing expenses (add-back) for TT purposes of €100,000 to €200,000; and

in principle, conversions in terms of the German Reorganisation Tax Act (RTA), for example, mergers, divisions and contributions, can be implemented with retroactive effect of up to eight months. According to the latest intended tax measures, the maximum period of the

implementation with retroactive effect shall be basically extended to 12 months for mergers, divisions and contributions in FY 2020. However, the German Government has already reserved its right for another extension of the period of retroactive effect until the end of FY 2021.