Recent Developments in International Taxation

Germany

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Amendment of the Foreign Tax Act

Overview

Based on the latest development 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.

Finally, parts of the draft law have been implemented with effect as of 1 January 2022.

Amendment of the TP Rules

Some of the amendments of the German TP rules according to the latest adjustments with effect as of 1 January 2022 are the following:

- The term ‘related person’ was amended in line with the ATAD (section 1 of the FTA).
- Section 1, paragraph 3 of the FTA explicitly includes the principles of any TP determination and audit, without resulting in significant changes to the previous determination and audit. The decisive factor for the assessment is the actual facts. In this context, the careful performance of functional and risk analysis, as well as a comparability analysis, is always indispensable in order to be able to make a proper assessment. Only then can a decision be made as to which TP method or whether the hypothetical arm’s length comparison should be used to determine the arm’s length price. The arm’s length comparison is to be based on the time of the contractual transaction.
- Specific rules on the determination of the bandwidth and narrowing of the range were amended, as well as rules on the application of the median value and mean value (section 1, paragraph 3a of the FTA).
Regulations on the relocation of functions were included in section 1, paragraph 3, sentences 9 and 10 of the FTA. However, the so-called escape clauses were reduced from three to one. In addition, the legal definition of a transfer of functions was changed to the effect that assets 'or' other benefits are to be transferred. However, this should not extend the scope of application.

The implementation of chapter VI of the OECD TP Guidelines on intangible assets (section 1, paragraph 3c of the FTA) was concretised. In this context, a definition of intangible assets was provided and, for the remuneration of intangible assets, it was stated that the value-driving functions, the so-called development, enhancement, maintenance, protection and exploitation (DEMPE) functions, that were actually exercised are decisive for pricing.

Exit taxation (section 6 of the FTA)

Exit taxation according to section 6 of the FTA Draft 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 amendment was implemented with effect as of 1 July 2021. The exit tax rules according to section 6 of the FTA provide for a shortened return clause within seven years (previously, 12 years) and a deferment option for the exit tax. Thus, upon request and by way of security, the deferred payment of exit tax for seven years is available. The deferment shall be revoked and the exit tax shall become due if, inter alia, the deferred payment is not paid in due time, the taxpayer files for insolvency or (in this case, only to the extent) the shares are sold or transferred.

CFC rules (sections 7–13 FTA)

The basic requirement of section 7 of the FTA presupposes that a foreign company is controlled by an unlimited taxpayer, if necessary, together with related persons (so-called add-on addresses, and that it generates low taxed so-called intermediate income (also called passive income). The legal consequence of this is that interim income is included in the tax assessment basis of the unlimited taxpayer as a so-called additional amount in accordance with the direct and indirect participation of the unlimited taxpayer (Hinzurechnungsbesteuerung).

Before the amendment of the German CFC rules, so-called 'domestic control' was the decisive factor, that is, taxpayers – affiliated or unaffiliated – jointly held more than half the shares in the foreign company. Now, section 7 of the FTA – in accordance with the requirements of Article 7 (1) of the ATAD – provides for a 'genuine' control concept. The concept of national control has been replaced by a shareholder-based approach that takes into account related parties. The decisive factor is now whether more than half the voting rights or more than half the shares in nominal capital are directly or indirectly attributable to the attribution addressee alone or together with
related persons, or whether there is a direct or indirect claim to more than half the profits or liquidation proceeds of the company.

**Amendment of the Real Estate Transfer Tax Act**

Almost two and a half years after the draft German Real Estate Transfer Tax Act (RETTA) was published, the amendment of the RETTA became effective as of 1 July 2021.

The main adjustments of the RETTA are the following:

- in general, the relevant participation thresholds were reduced from 95 per cent to 90 per cent;
- extension of the period under review from five years to ten years;
- implementation of an additional real estate transfer tax (RET) event for corporations owning real estate property (section 1(2b) of the RETTA): according to the new rules RETT will be triggered if 90 per cent or more of the shares in a corporation owning German real estate are transferred to one or several new shareholder(s) within a time period of ten years whereby RETT is triggered by closing;
- implementation of an exemption clause for corporations listed on the stock exchange (eg, within the meaning of section 2(11) of the German Securities Trading Act) owning real estate property (section 1(2c) of the RETTA); and
- application of the amended RETTA to acquisitions as of 1 July 2021.

Prior to the amendment of the RETTA and the implementation of the new RETT event for share transfers in terms of section 1(2b) of the RETTA, an analogue RETT event already existed for real estate-owning partnerships, according to which the transfer of interests to new partners was to trigger RETT if the relevant threshold/limits were exceeded (previously, a transfer of 95 per cent or more interests within five years, as of 1 July 2021, or 90 per cent or more within ten years). This kind of RETT event was now copied to corporations and their share transfers by analogy. A great impact of the amendment of the RETTA therefore refers to the direct and indirect transfer of shares in corporations owning real estate companies after 30 June 2021. Prior to the reform of the RETTA, for example, the (in)direct combination of 90 per cent or more on the one hand or the transfer from such a shareholding on the other hand triggered RETT (section 1(3, 3a) of the RETTA). If shares are now transferred to new shareholders, these share transfers are to be monitored for a period of ten years as to whether and, if so, when a total of 90 per cent or more of the shares were transferred to a total of new shareholders. Thus, in the case of direct or indirect share transfers of real estate owning corporations, whether German RETT is triggered must be checked in more detail.