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Recent Developments in International Taxation

GERMANY

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A. Overview of current discussions

German tax legislation is currently very driven by the various crises (war of aggression in Ukraine, energy crisis, inflation, aftermath of the Corona pandemic, etc.). Accordingly, the measures that tax lawmakers have implemented so far and still need to implement are widely spread. These include, for example, adjustments to the progressive income tax scale to avoid cold progression. This arises when increases in income, which are intended to compensate for inflation, lead to an increase in the average tax burden as a result of the progressive income tax rate while real income remains unchanged. In addition, there were increases in tax allowances, the continuation of the reduced VAT rate for restaurant and catering services, the tax exemption (VAT, income tax) for certain photovoltaic systems etc.

In addition, German tax policy is also significantly influenced by European tax policy and ultimately also by the developments of the OECD, which is increasingly assuming the role of a world tax organization. With a corporate tax rate of around 30%, Germany continues to lead the field in an international comparison. While energy prices and ever more extensive compliance obligations are also placing a heavy burden on companies, the Inflation Reduction Act in the USA, for example, provides relief for companies. The German Ministry of Finance is therefore currently working on

- a "Future Financing Act" (*Zukunftsfinanzierungsgesetz*)
  (Objectives: improved capital market access for start-ups, improvement of the tax framework for employee share ownership),

- a "Tax Fairness Act" (*Steuerfairnessgesetz*)
  (Objectives: combating tax fraud, increasing transparency and improving information exchange, simplifying the tax system, eliminating the problems of so-called "register cases"),

- a "Competition Strengthening Act" (*Wettbewerbsstärkungsgesetz*)
  (Objectives: Tax incentives for climate protection and energy efficiency, equalization of taxation disadvantages for partnerships compared with corporations), and

- the "Minimum Tax Directive Implementation Act" (*Mindestbesteuerungsrichtlinie-Umsetzungsgesetz*) to implement the Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

B. Measures taken or planned in the context of cross-border cases

I. Repayment of contributions made to the capital of companies not resident in the European Union

The Annual Tax Act 2022 (*Jahressteuergesetz 2022*) of December 20, 2022 regulated, among other things, the tax treatment of the repayment of contributions made to the capital of a company not resident in the European Union, which qualifies as a corporation from a German tax perspective.

The German tax authorities already treated the repayment of contributions made by companies resident in the European Union as taxable if the foreign company did not maintain a special taxable contribution account. Even in the case of repayments from the nominal capital, a taxation could be triggered. Conversely: A tax-free (and thus systematically correct) return of contributions is only possible if

- the foreign company submits a (very time-consuming) application to the German Federal Central Tax Office for a separate determination of a return of capital contributions
- using an officially prescribed form, including a description of the relevant circumstances (annual financial statements, reconciliation accounts, in particular, a complete history of the tax contribution account, which foreign countries are not familiar with in the vast majority of cases, etc.)
- by the end of the twelfth month following the end of the business year in which the repayment was done, and
- the application is approved by the authorities (after sometimes very long processing times).

Contrary to previous case law and administrative practice, it is no longer possible for the shareholder to provide evidence of a tax-free return of contributions.

In order to avoid this problem for shareholders resident in Germany for tax purposes, the shares in the company could be sold, for example, in order to be able to claim the original acquisition costs to reduce tax when determining the income from the sale.

II. Implementation of the Minimum Tax Directive

In December 2022, EU Member States reached the necessary unanimity to adopt the Directive implementing OECD Pillar Two in the EU. On December 22, 2022, the EU published a draft directive to implement the internationally agreed minimum tax in order to legally implement the global agreement among some 140 countries on a global minimum tax on corporate profits of 15% ("*top-up tax*"). However, the goal of a level playing field will not be achieved as long as economically strong nations, such as the USA, with which Germany is competing on tax conditions, do not implement the regulations.

Currently, Germany is discussing implementation on the basis of a 242-page discussion draft for a separate 89-paragraph act to implement the directive published by the German Federal Ministry of Finance, which shows a significant increase in compliance costs for companies. Reactions to the discussion draft are very diverse. Critical items include amongst others:

- Group-wide implementation of complex processes and IT structures required for data collection, preparation and declaration as well as for calculation of the respective supplementary taxes,
- Collection of the required data is very time-consuming and there are high penalties in the event of errors,
- Extensive adjustments to previous accounting up to annual financial statements (especially also for non-consolidated subsidiaries and permanent establishments),
- Numerous problems with details, also due to undefined legal terms, and
- Considerable additional expense for affected companies with only very low expected tax revenue ("low single-digit billion range"); high costs and high consumption of resources are also expected on the part of the tax authorities.

As the directive has to be implemented in 2023 and numerous individual associations ("*Verbände*") and specialist groups reacted on the draft, the final version of the law to be promulgated is eagerly awaited.

III. Amendment of German Foreign Tax Act: New Decree of the Federal Ministry of Finance

As a result of the Anti-tax Avoidance Directive II, German Foreign Tax Act ("*Außensteuergesetz*") has been amended and, for the most part, tightened in various areas, mainly with effect from 2022. These include, among other things,[1] changes to

- the regulations on transfer pricing,
- exit taxation ("*Wegzugsbesteuerung*") with regard to individuals holding shares in corporations,
- the controlled foreign corporation rules ("*Hinzurechnungsbesteuerung*"), and
- the regulations on family foundations.

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[1] See IBA National Report (Germany) 2022 provided by R Wald.

These changes, some of which are very extensive, are explained in more detail in a detailed circular issued by the Federal Ministry of Finance, which sets out the Ministry's position on the statutory changes and individual issues. A discussion draft of this decree is expected to be published in early to mid-July 2023 and is currently awaited with great anticipation.

IV. Particularities of company reorganizations outside the EU or the EEA

Also with effect from calendar year 2022, the scope of application of the German Reorganization Tax Act ("*Umwandlungsteuergesetz*") has been extended regarding mergers, splits and spin-offs of corporations as well as changes of the legal form of a corporation into a partnership or comparable foreign transactions respectively.

On the one hand, the German Reorganization Tax Act is intended to remove tax obstacles, inter alia, in the case of cross-border and purely foreign reorganizations of companies and to improve the possibilities for the free choice of legal form. This is basically achieved by the possibility of continuing book values in the (tax) balance sheets of the companies involved in reorganizations, subject to application, or of continuing the acquisition costs in the case of certain shareholders. On the other hand, however, the German tax base is also (sometimes too) consistently safeguarded, especially in the case of cross-border conversions. For example, the possibility of continuing the book values or acquisition costs is linked to sometimes strict conditions or, in the event of a later actual sale, a German taxation right is secured irrespective of a double taxation agreement.

Mergers, splits and spin-offs of corporations as well as changes of the legal form of corporations, associations of persons and estates, which, for example, were founded outside the EU / EEA, i.e. in third countries, and have neither management nor registered office in Germany, were not covered by the German Reorganization Tax Act prior to this amendment.

As a result of the extension of the scope of application of the German Reorganization Tax Act, the same rules apply to third-country mergers (irrespective of a limited tax liability or the tax residency of the remaining corporation) as to domestic, cross-border or foreign EU / EEA mergers. In addition, third-country splits and spin-offs of corporations as well as third-country changes of legal form and of the shareholders involved in the conversion now also have, in principle, the possibility of a tax-neutral conversion. Likewise, the previously very critical mandatory order of final taxation due to (assumed) liquidation in the event of a transfer of the administrative seat or the registered office of a corporation, association of persons or estate from Germany to a third country (also irrespective of the safeguarding of German taxation rights) has been deleted without replacement.