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Corona Disease: Tax measures to protect businesses and jobs

On 13 March 2020, Federal Finance Minister Scholz and Federal Economics Minister Altmaier presented a package of Measures to cushion the Economic Impact of the Coronavirus (COVID-19). The aim of the package is to provide companies and businesses with sufficient liquidity to secure growth and employment.

In addition to facilitating access to short-time working hours allowance and low-interest loans, especially loans from the *KfW* (Kreditanstalt für Wiederaufbau), the following **tax-based liquidity assistance** for companies is planned:

– As **fiscal liquidity support**, improved possibilities for deferring tax payments, reducing advance payments and in the area of enforcement are to be granted.

– **Deferments**: The granting of deferrals should be facilitated. The tax authorities can defer taxes if the collection would represent a considerable hardship. The tax authorities are to be instructed not to make any strict demands. This will support the liquidity of the taxpayer by postponing the date of tax payment. A restriction to certain types of tax is not to be taken from the press release. According to the statements made at the press conference, the deferrals are to be made interest-free.

– **Advance payments**: It should be easier to adjust advance tax payments. As soon as it is clear that the income of the taxpayer in the current year will probably be lower, the tax prepayments are to be reduced quickly and easily. This will improve the liquidity situation. The press release also does not restrict advance payments to certain types of tax.

– **Enforcement measures**: Enforcement measures (e.g. seizure of bank accounts) or late payment surcharges should be waived until 31 December 2020 while the taxpayer is directly affected by the effects of the corona virus.

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- In the case of taxes administered by the **Customs Administration** (such as the energy tax and the air travel tax), the Directorate General of Customs was instructed to grant appropriate measures.

The same applies to the **Federal Central Tax Office**, which is responsible for insurance tax and VAT.

These planned tax measures can be implemented through administrative procedures. A legislative procedure is not necessary in this respect. However, coordination with the Federal States is necessary, which has already been initiated by the Federal Ministry of Finance. To make use of such measures, a corresponding application must be submitted to the responsible tax office.

German Federal Tax Court [BFH] (I R 13/18; I R 26/18): No trade tax liability for capital gains arising from contributions (contribution gain I and II)

In its judgements of 11 July 2019 (file ref. I R 26/18 and I R 13/18), the German Federal Tax Court [BFH] ruled that 'contribution gain I' attributable to the sale of shares by a natural person subject to a vesting period – sale of shares received in connection with a contribution – or 'contribution gain II' induced by the acquiring corporation – sale of contributed shares – is not subject to trade tax if contribution (of the shares) at fair market value would also not have been subject to trade tax.

Contribution gain I

If a business, operating unit or partnership interest is contributed to a corporation (transferee), and if the transferring company (transferor) in return receives new shares in the company (contribution), the receiving corporation must recognize the contributed assets at fair market value. In derogation therefrom, upon request, these assets may under certain circumstances be recognized at book value or at a value in between book value and fair market value. Where the transferor sells the shares received in connection with such a contribution at less than fair market value within seven years of contribution, the contribution will nevertheless be retroactively assessed based on fair market value. For the contributing entity, the resulting gain on contribution is subject to retroactive taxation in the financial year of contribution (contribution gain I). Similar regulations apply to change of legal form from a partnership to a corporation.

In the case decided by the BFH (I R 26/18), the plaintiff originally was a limited partnership with a limited liability company as general partner (GmbH & Co KG), whose limited partners included individuals. With retroactive effect from 31 March 2013, the limited partnership was converted into a German corporation limited by shares (Aktiengesellschaft or 'AG'), carrying over the book values so that hidden reserves were not disclosed. Subsequently, a partner – an individual – transferred part of the shares received in the acquiring corporation (which are subject to a vesting period) within seven years. In the course of a tax audit, the tax office determined (indisputable) capital gains arising from contributions (contribution gain I). However, it was in dispute between the parties involved whether the contribution gain is also subject to trade tax, because, in principle, the sale or discontinuation of business operations or of a partnership interest by individuals is not subject to trade tax. However, in the opinion of the Federal Ministry of Finance, sale of a business operation can no longer be assumed when after contribution of a business operation or partnership interest not all the shares received in return are sold in one transaction.

Contribution gain II

Where shares in a corporation (acquired corporation) are contributed to another corporation (receiving corporation) in exchange for new shares in the receiving corporation (share-for-share deal), the receiving corporation must recognize the contributed shares at fair market value. In derogation, upon request they may be recognized at book value or a value between the book value and fair market value, if upon the contribution the receiving corporation, based on its shareholding including the contributed shares, verifiably directly holds the majority of the voting rights in the acquired corporation (qualified share-for-share deal). Where the receiving corporation directly or indirectly sells shares contributed at less than fair market value under such a share-for-share deal within seven years from the time of contribution, the share transfer will retroactively nevertheless be assessed based on the fair market value. For the contributing entity, the resulting gain on contribution is subject to retroactive taxation in the financial year of the contribution (contribution gain II). The retroactive recognition at fair market value does not apply to the extent that the gain on sale of the shares would have been tax exempt at the time of the contribution, e.g. in the case of corporations pursuant to § 8b (2) Corporate Income Tax Law (KStG).

In the case before the BFH (file ref. I R 13/18), a natural person (A) had a partnership interest in a limited partnership [KG]. The KG's business assets for tax purposes included interests in corporations. Moreover, 'A' held ownership interests in a German limited liability company [B-GmbH]. In the year under dispute (2010), 'A' contributed the interests in the KG together with the interests in corporations at book value in exchange for new interests in B-GmbH. Still in the same year, all interests in corporations contributed were resold by B-GmbH.

The transfer indisputably resulted in capital gains arising from contributions (contribution gain II). The issue was whether the contribution gain II is also subject to trade tax. In the opinion of the tax authorities, contribution gain II is subject to trade tax because it selectively imposes tax only on the sale of contributed shares in corporations and not on the sale of the entire partnership interest.

In the opinion of the BFH, and therefore contrary to the tax authorities' opinion, neither contribution gain I nor contribution gain II is subject to trade tax in the matters at hand. This is supported by the letter and structure of the law (German Reorganization Tax Act [UmwStG] Section 22 (1) and (2)). The regulation stipulates the retroactive increase of the gains generated by the contribution (of shares). It therefore seems reasonable, also for the purposes of trade tax, to make the contribution gain I and contribution gain II subject to the legal rules that would have applied to the realisation of gains on the date of contribution. This is also supported by the fact that the legislator has not provided special legal regulations for the trade tax treatment of contribution gain I and contribution gain II. That the contribution gain I and contribution gain II is not subject to trade tax in the matter at hand because the contribution of the entire partnership interest or share in corporations would not have induced trade tax, even in applying the fair market value, is in line with the intent and purpose of the Reorganisation Tax Act.

Rules for applying the license threshold (German Income Tax Act [EStG], Section 4j)

The so-called licence threshold (Section 4j EStG) provides for the (proportional) non-deductibility of expenses arising from the transfer of rights, if the corresponding revenue is subject to a low preferential tax regime (so-called licence box, patent box, IP box) for the payee. One exception from non-deductibility applies to preferential tax regimes that are in line with the so-called nexus approach of the OECD.

The guidance issued by the Federal Ministry of Finance [BMF] on 19 February 2020 includes a list of preferential arrangements that are not in compliance with the OECD nexus approach in the 2018 tax assessment period, based on the review conducted by the BMF. Moreover, a second list shows preferential arrangements which have not been finally reviewed.

The list of preferential arrangements that are not in compliance with the nexus approach in assessment period 2018 includes a total of 54 preferential tax regimes. The exemption from non-deductibility does not apply to these tax regimes. The BMF expressly emphasizes that this list of harmful arrangements (harmful tax practices) is non-exhaustive. The list is meant as a tool and shows all harmful tax practices so far determined by the Federal Ministry of Finance [BMF].

The tax regimes of the countries specified on this list will largely "expire" by 2021. The countries concerned have either created new regimes in line with nexus or revoked their tax regimes classified as non-compliant with nexus. It is taken into account on the list under "period of application" that these countries are permitted to continue applying their existing regimes until 30 June 2021 pursuant to the BEPS agreements for non-nexus-compliant regimes. However, any such grandfather clause is of no concern for application of the licence threshold.

Furthermore, it needs to be considered that in some countries there are new non-harmful preferential tax regimes in addition to the harmful tax practices shown, which use the OECD grandfather clause until 30 June 2021. It therefore needs to be assessed on a case-by-case basis which preferential tax regime was used to apply a low tax rate to the payee's licence payments.

However, this does not permit the reverse conclusion that any preferential tax regimes not specified on the list are in compliance with the nexus approach.

Cases in which payments within the meaning of the licence threshold are taxed directly or indirectly in preferential tax regimes that have not been finally reviewed according to the second list should be kept procedurally open according to the BMF until a final review of nexus conformity has been established. These must therefore be assessed subject to review pursuant to Section 164 of the German Tax Code [AO]. Preferential tax regimes that have not been finally reviewed include the US Foreign-Derived Intangible Income (FDII) tax regime.

In conclusion, the BMF notes that the above-mentioned lists are not exhaustive, as it is not ensured, due to tax legislation around the globe, that all preferential tax regimes used worldwide have been identified and reviewed.

BMF guidance on compensation payments in cases of income tax group (German Corporation Tax Act [KStG], Section 14 (2))

The German Tax Act 2018 for the first time specifies the amount of compensation for tax purposes in a new section added to the German Corporation Tax Act (Section 14 (2) KStG). According to this new provision, the entire profit is considered transferred even "when compensation payments are agreed and paid beyond the minimum guaranteed amount pursuant to Section 304 (2) sentence 1 of the German Stock Corporation Act [AktG]." However, this applies only if the compensation payments do not exceed the respective profit share for the financial year that could have been paid without a profit transfer agreement (so-called maximum amount).

The BMF has now commented on the agreement of compensation payments pursuant to Section 14 (2) KStG in its guidance of 4 March 2020:

1. Scope of application of Section 14 (2) KStG

It is irrelevant for application whether the compensation payments are rendered by the controlled entity or controlling entity. However, the rule only applies if compensation payments are agreed and paid. Section 14 (2) KStG therefore does not apply in financial years in which the variable component of the amount is actually not paid (e.g. due to a loss). In the opinion of the BMF, the regulatory restrictions must also be observed if only variable compensation payment has been agreed, based on the controlling entity's profit.

2. Maximum compensation amount

The notional profit share of the external shareholder must always be based on the controlled entity's total profit. The percentage of share capital is decisive in this regard, not some contractually agreed divisional profit or similar. The maximum amount of compensation is the amount that could have been paid to an external shareholder without a profit transfer agreement (stand-alone approach). This is based on net income for the year before profit transfer according to German commercial law. This amount must be reduced in particular by contributions to statutory reserves and other revenue reserves, by amounts restricted from distribution and by notional income tax amounts. It must be increased in particular by the release of the aforementioned reserves formed during the tax group, compensation payments and corporation tax on compensation payments, to the extent that these have reduced net income for the year. The maximum amount must be determined separately for each financial year.

3. "Sound business judgement test" according to Section 14 (2) sentence 3 KStG

The variable compensation amount must be "based on sound business judgement". This "sound business judgement test" is to prevent arbitrary compensation payments according to the BMF guidance.

4. Legal implications

If the total amount of compensation payments exceeds the maximum amount permitted pursuant to Section 14 (2) KStG, this precludes acceptance of the consolidated tax group.

Federal Ministry of Finance draft guidance on the application of the provisions on the mandatory reporting requirements for cross-border tax planning arrangements

The Act on the implementation of mandatory reporting requirements for cross-border tax planning arrangements was promulgated in the Federal Law Gazette (BGBl. [Bundesgesetzblatt] I 2019, p. 2875) on 30 December 2019. The Act implements the amendments to the Directive on Administrative Cooperation (so-called DAC 6) as regards the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (Council Directive (EU) 2018/822 of 25 May 2018). Now, the Federal Ministry of Finance (BMF) has sent a BMF draft guidance on the application of the provisions on the mandatory reporting requirements for cross-border tax planning arrangements (as at 2 March 2020) to the associations. After hearing the associations and final consultation with the highest tax authorities of the Laender, the BMF guidance is expected to be finally published in the summer.

Hallmarks (§ 138e AO)

§ 138e AO includes a final abstract list of hallmarks triggering a reportable arrangement. In this regard, § 138e (1) AO records the conditional hallmarks to which additionally the relevance test of § 138d (2) sentence 1 no. 3 letter a) AO is applicable (“main benefit” test). The “main benefit” test requires that a reasonable third party, having regard of all relevant facts and circumstances, may reasonably expect that the main benefit or one of the main benefits is the obtaining of a tax advantage within the meaning of § 138d (3) AO. Otherwise, there is no reporting obligation.

Evidence to the contrary can be provided by, for example, setting out mainly non-tax related (in particular economic) reasons for the specific structuring of a transaction through which the tax advantage becomes secondary. Thereby, it has to be plausibly demonstrated that the tax advantage does not constitute a main benefit of the arrangement (margin no. 96).

In an annex to the BMF guidance, eight case groups within the meaning of § 138d (3) sentence 3 AO from the areas of inheritance tax/gift tax (e.g. property regime clauses on the basis of § 5 Inheritance Tax Act [ErbStG]) and income tax/retirement provisions (e.g. conclusion of base annuity contracts and retirement provision contracts certified pursuant to § 5a of the Retirement Provisions Certification Act [AltZertG]) as well as the Research Allowance Act [FZulG] are listed which, ultimately, shall all be exempted from a reporting obligation (white list). Thus, the BMF makes only limited use of the possibility to identify non-reportable case groups where the tax advantage solely arises in Germany and is provided for by law (§ 138d (3) sentence 3 AO). A large number of advantages relevant for enterprises and provided for by law are not listed in the present draft of the white list.

Postponement of first disclosure

Following the draft guidance, the first disclosure shall be postponed by two months: If the first step of a reportable cross-border tax arrangement was implemented after 24 June 2018 and before 1 July 2020, the report must be submitted to the BZSt, in derogation from § 138f (2) AO (30 days), within two months after 30 June 2020. Since the interface connection is only available as from 1 August 2020, there will be no objections if these cross-border tax arrangements are communicated by 30 September 2020 (margin no. 267).

Where the event giving rise to the reporting obligation has occurred after 30 June 2020, the report can, also in these cases, only be submitted as from 1 August 2020, at the earliest. In these cases, too, any failure to meet a deadline until 30 September 2020 will not be objected to under § 138f (2) AO (margin no. 268).

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THE SQUAIRE, Am Flughafen
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Editorial Team
Prof. Dr. Gerrit Adrian
(Responsible*)
gadrian@kpmg.com

Veronika Aschenbrenner
Julian Fey
Alexander Hahn
Ilhan Yilmaz

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