German Tax Monthly

Information on the latest tax developments in Germany

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Proclamation of the Second Coronavirus Tax Assistance Act

The Bundestag and the Bundesrat passed the Second Act on the implementation of tax relief measures to cope with the Covid-19 crisis (Second Coronavirus Tax Assistance Act) on 29 June 2020. The act was announced in the Federal Law Gazette (BGBl. I, p. 1512) on 30 June 2020. The act implements the tax measures of the stimulus package proposed by the government coalition, which should take effect as quickly as possible.

Key points of the "Second Coronavirus Tax Assistance Act":

VAT rate reduction: Six-month reduction of VAT from 19% to 16% as well as from 7% to 5% for the reduced VAT rate (in both cases from 1 July 2020 to 31 December 2020); an application guidance has also been published by the BMF on 30 June 2020.

Deferral of import VAT: The due date for payment of import VAT will be deferred until the 26th of the second month following the import. The Government aims an application of the new provision in January 2021.

Loss carryback: The tax loss carryback (for income tax and corporate income tax) for the years 2020 and 2021 is increased to €5m or, in the event of joint assessment, to €10m. An adjustment (relief) of minimum taxation for loss carryforwards is not foreseen. It should be possible to utilize the (increased) loss carryback for 2020 to adjust prepayments for the assessment period 2019. Upon request, tax prepayments for the assessment period 2019 can be reduced retroactively by reducing the total income used by a flat 30% rate, €5m max. (or €10m in the event of joint assessment). Further, in the assessment period 2019, an amount of 30% of the total income may be deducted, upon request, as a "preliminary loss carryback" from 2020, €5m max (or €10m in the event of joint assessment). Both measures are subject to the condition that the prepayments for 2020 were reduced to zero.

Re-introduction of the declining-balance method of depreciation: For moveable fixed assets acquired or produced in 2020 and 2021 in the amount of up to 25 percent per year, at most 2.5

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times the factor of the straight-line depreciation method.

The **periods for tax privileged (re-)investments** according to § 6b Income Tax Act (to the extent a reinvestment reserve is still remaining and would have to be dissolved at the end of a fiscal year ending after 29 February 2020 and before 1 January 2021) and § 7g Income Tax Act are extended for one year. Further, the BMF is authorized to prolong the period for reinvestments (§ 6b Income Tax Act) by one more year.

Trade tax add-backs: The allowance for trade tax add-back of financing expenses pursuant is increased, as of assessment period 2020, from €100,000 to €200,000.

Tax incentive for research: For eligible expenses incurred after 30 June 2020 and before 1 July 2026, the rate of the tax incentive for research is to be granted on an assessment base of up to €4m per enterprise; hence, the maximum incentive would amount to €1m per year (25% of the assessment base).The upper limit of the assessment base until June 2020 was €2m (hence, the maximum incentive €500,000 per year).

Interim Aid for Small and Medium-Sized Enterprises

On 12 June 2020, the Federal Government decided on the key points of the interim aid for small and medium-sized enterprises.

The objective of the program is to secure the economic existence of small and medium-sized enterprises incurring significant losses in sales due to Covid-19-related complete or partial closures or requirements. In our understanding, whether a small or medium-sized company is present is to be assessed by a stand-alone consideration, not by a group view.

Applications for interim aid may be submitted inter alia by small and medium-sized enterprises and organizations from all economic sectors. Applicants must not have been in difficulty, pursuant to the EU definition, on 31 December 2019.

Enterprises qualifying for the Economic Stabilization Fund ('Wirtschaftsstabilisierungsfonds') are not eligible for application. These are enterprises which have fulfilled at least two of the three following criteria in the last two completed fiscal years prior to 1 January 2020:

a) balance sheet total of more than €43 million,

b) net sales of more than €50 million as well as

c) more than 249 employees on an annual average.

The application for interim aid is conditional on the cessation of business activities, either complete or to a significant extent, as a result the Covid-19 pandemic. That is assumed if sales in the months April and March 2020 together have dropped by at least 60% compared to April and May 2019. For companies founded after April 2019, the months November and December 2019 must be taken as basis for comparison instead of the months April and May 2019.

The interim aid grants a staggered subsidy depending on the decline in sales. The maximum financial support shall be limited to €150,000 in total for three months.

Application and provision of evidence for the decline in sales on which the claim and the recoverable fixed costs are based follow a two-stage procedure.

At the first stage (filing of application), the prerequisites for filing an application and the amount of the recoverable fixed costs must be credibly shown with the help of a tax advisor or an auditor; at the second stage (subsequent provision of evidence) these must be substantiated with the help of a tax advisor or auditor.

Where the actual turnover deviates from the forecast, subsidies paid in excess must be paid back, insufficient subsidies will be subsequently topped up. Applications must be filed by 31 August 2020 at the latest, payments must be made by 30 November 2020. Guidelines, execution notes, application forms and FAQ are currently being elaborated by the Federal States.

Federal Tax Court (I R 14/18, I R 34/18 and I R 21/18): New Judgments on Income Correction according to § 1 (1) AStG

With three decisions, the First Senate of the German Federal Tax Court (BFH) has lately consolidated its recent judgment on income correction according to § 1 (1) Foreign Transactions Tax Act [AStG]. In all cases, the BFH decided that the absence of loan collateral generally falls under 'non-arm's-length conditions' as defined by § 1 (1) AStG. The same applies for Article 9 (1) of the OECD Model Tax Convention (OECD MTC). Article 9 (1) OECD MTC does not limit the scope of correction of § 1 (1) AStG to price adjustments; it also allows the elimination of the profit-reducing derecognition of a loan receivable or write-down to fair value.

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In the first case (Az. I R 14/18), the plaintiff, a German stock corporation, was the sole shareholder of C Inc., a corporation from the USA, in 2006 (year under dispute). C Inc. was over-indebted at 31 December 2005. For this reason, the plaintiff granted C Inc. loans in the form of promissory notes. The promissory notes did not provide for any collateral. The agreed interest rate was based on the prime rate, the rate given by US commercial banks to their most creditworthy clients, plus one percentage point. At the end of 2006, C Inc. suspended its operating new business, and the plaintiff recognised a profit-reducing write-down on the loans. The BFH found in favour of the tax office that the reduction in profits was eliminated given the absence of any loan collateral according to § 1 (1) AStG. According to the BFH, the circumstances identified (the borrower's over-indebtedness and permanent loss-making situation as of 31 December 2005) would preclude a third party from having granted the agreed promissory note without valuable collateral. Moreover, the BFH pointed out, it is not at all evident that a third party would have compensated the lack of collateral with an interest mark-up. Promissory notes are typically granted without collateral only if the borrower has an excellent credit rating.

In the second case (Az. I R 34/18), the plaintiff was a German general partnership (OHG) whose investors were exclusively corporate entities. It was the sole shareholder of A S.R.L. (A), an Italian corporation, in 2002 and 2004 (years under dispute). An unsettled receivable from an overdraft facility existed against that company in 2002. The receivable bore interest at different rates in the years under dispute and was unsecured. The plaintiff opted several times to not receive parts of the receivable and instead to have a debtor warrant; in the opinion of the parties to the contract, these parts constituted the worthless portion of the receivables. These amounts were derecognised in the plaintiff’s balance sheet, thereby reducing profit. The court found in favour of the tax office on this matter also, judging that the profit reduction according to § 1 (1) AStG was eliminated. In this case, too, the borrower was in a permanent loss-making situation. In the court's opinion, it was also in this case not evident that the agreed interest rate, which was on average 2 percentage points above the respective base rate, could compensate the absence of collateral and the associated risk of default. It was pointed out that an income correction pursuant to § 1 (1) AStG is not in contravention of EU law. According to the BFH, in cases involving a purely artificial arrangement, a correction under § 1 (1) AStG is consistent 'per se' with European Law. If, on the other hand, the case does not involve a purely artificial arrangement, the national court must consider the economic reasons and measure them by assessing the respective deviation from the arm's length benchmark under review and how seriously this interferes with the territoriality principle and the attribution of tax jurisdiction resting on that principle. Differential treatment of capital contribution and loan default is precluded if a shareholder's issuance of debt capital equates to an insufficient provision of equity for the company and this financing is the condition for the borrower company being able to (continue to) fulfil its intended economic function.

In the third case (Az. I R 21/18) the plaintiff was the universal successor to R-GmbH. R-GmbH had granted T-S.A.R.L. (a French subsidiary) loans with an interest rate of 6% p.a., which were unsecured. The repayment date and rates were not defined and were intended to be specified only at a later date. At 31 December 2005 and at 31 December 2006 (years under dispute), R-GmbH wrote down its loans, thereby reducing profit. T-S.A.R.L. was liquidated in 2007. The BFH essentially came to the same conclusion as in the second case. However, the BFH has had to refer the matter to the lower tax court for a further hearing and decision, as the lower tax court's findings are not sufficient to assess whether the profit-reducing write-downs are to be eliminated. The lower tax court must now assess the totality of the objective facts to distinguish between a loan initiated for operational purposes and a capital contribution initiated based on an ownership relationship. According to the BFH, this distinction must be based particularly on whether the allocated capital was intended to be transferred permanently to T-S.A.R.L.'s assets and there was no intention of repayment, or whether the participants, within the meaning of a serious agreement, assumed that the capital would be granted temporarily and could assume that the loan agreement would be implemented, i.e. that the loan would be repaid.

The lower court had in all three cases decided in favour of the taxable entity, basing its decision on the earlier judgment of the BFH on income correction according to § 1 (1) AStG and the overriding effect of Article 9 (1) OECD MTC. These decisions have now been overturned by the BFH.

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Lower Saxony State Office for Taxes: Corporate Tax Treatment of Foreign Exchange Losses in Group Cases

The Lower Saxony State Office for Taxes issued a decree dated 21 April 2020 in which it made a statement on arm's length hedging of foreign exchange losses.

According to § 8b (3) sent. 4 of the German Corporation Tax Act (KStG), profit reductions related to a loan receivable are to be disregarded for tax purposes under certain circumstances. This includes profit reductions related to a loan receivable if the loan is granted by a shareholder with an indirect or direct investment of more than 25% in the corporation to which the loan has been granted. The wording of § 8b (3) sent. 4 KStG only covers the loan. However, this non-deductibility does not apply if a third party, with all other circumstances remaining the same, were to have granted the loan or not yet reclaimed the loan (counterevidence option).

Profit reductions can also arise due to movements in exchange rates. In the opinion of the Lower Saxony State Office for Taxes, these foreign exchange losses are also not deductible. Offsetting income from hedging transactions cannot be recognised as a netting mechanism in such cases. The counterevidence option is possible only if the whole loan is hedged at arm's length and not just the foreign exchange risk alone. If the foreign exchange risk is hedged at arm's length in isolation (while other conditions of the loan are not arm's length), this cannot lead to partial deductibility for the foreign exchange losses alone.

The decree of the Lower Saxony State Office for Taxes is binding for the tax offices belonging to it. The document does not reveal whether it has been agreed nationwide.

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