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Information on the latest tax developments in Germany

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Government Draft Bill on an Act to Modernize the Relief from Withholding Tax

On 20 January 2021, the German Federal Government adopted the draft bill of an 'Act to Modernize the Relief from Withholding Tax and the Certification of Capital Gains Tax'.

The key points of this draft bill are:

- Revision of the **anti-treaty shopping rule**
- Amendments to the provisions governing the **relief procedure** for foreign taxpayers from **withholding tax**
- **Capital gains tax**: Further information regarding tax certificates and withholding tax, reporting obligations to the German Federal Central Tax Office [BZSt] as well as liability in the event of incorrect tax certificates
- Reorganization tax: **Prohibition on offsetting losses in the retroactive period** for certain arrangements involving financial instruments and participations
- Amendments to the provisions on the **arm's length principle** under the Foreign Tax Act

The repeal of non-resident tax status for granting and transfers of rights based on the mere entry of rights in a domestic register intended in the ministerial draft (November 2020) was not adopted in the government bill. By letter dated 6 November 2020, the German Federal Ministry of Finance [BMF] con-firmed the existing tax liability upon transferring or selling a right (e.g. patents) where entered in a domes-tic public register. According to reports, a simplified procedure is to be created within the administrative channels for cases which are subject to non-resident tax status and withholding tax solely on the basis of entry in a domestic register and for which, on account of a DTA, no tax liability is ultimately incurred. The details of this have thus far not been disclosed.

Anti-Treaty Shopping Rule

The anti-abuse rule is to undergo substantial revision. We introduced the amendments in our previous GTM issue December 2020. A new aspect in the

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government draft bill is that the amendments are generally applicable in all open cases, unless the anti-treaty shopping rule in the version applicable at the time the income accrued does not prevent the claim for relief.

Rules of Procedure / Withholding Tax on Capital Gains / Offsetting Losses in the Retroactive Period

There have been no changes to these amendments compared to the ministerial draft bill, which we have introduced in our previous GTM issue December 2020.

Transfer Pricing

With this draft bill, extensive revisions are to be made to the provisions governing transfer pricing. According to the explanatory memorandum to the Act, the design of the provisions to ensure a fair division of taxation rights in the case of multinational enterprises is to be updated. The provisions correspond with those included in the ministerial draft on the Implementation of the ATAD dated 24 March 2020. Only the provision governing financing relationships (draft § 1a Foreign Tax Act in the version of the ministerial draft on the Implementation of the ATAD) was not adopted.

The wording of the provisions on the adjustment of income shall be revised extensively and, thereby, closer aligned to the **OECD transfer pricing guidelines**. According to the explanatory memorandum, the proposed changes are intended to clarify and highlight substance over form and provide general rules, benchmarked against international practice, for the determination and verification of transfer prices. The existing hierarchy of methods with the primacy of the standard methods (comparable uncontrolled price method, resale method and cost-plus method) shall be dropped. The "most suitable method" shall be applied instead.

In order to determine the arm's length price, first of all the actual price-impacting circumstances underlying the respective transaction to be examined must be determined by way of a function and risk analysis as well as a comparability analysis. The principle of substance over form shall come to the fore.

At the same time, specific particularities – circumstances which cannot be agreed – of a group shall be taken into account. According to the explanatory memorandum, however, this does not mean that practices which comply with group standards are at arm's length; rather, compliant with group standards and at arm's length are to be kept apart. An economics-based assessment needs to take the specific features of a group of companies into account. In cases where, for example, an interest rate for a loan between affiliated companies is stated that turns out to be lower than an interest rate to be found on the market, this does not necessarily need to be qualified as not at arm's length and lead to an adjustment. A reason for the lower interest rate could be lower transaction costs between the affiliated companies.

The separate provisions on transfer pricing in the event of the transfer or licensing of intangible assets are new as well. The concept of an intangible asset is legally defined, in close alignment with the OECD transfer pricing guidelines, for the first time. The proprietor or owner of the intangible asset must compensate related persons adequately if and in so far as they perform services or exercise functions in relation to the intangible asset (in connection with the development or creation, the enhancement, the maintenance, the protection, or any kind of exploitation of the intangible asset; so-called "DEMPE" concept: Development, Enhancement, Maintenance, Protection, and Exploitation).

The already existing provisions regarding so-called **price-adjustment clauses** for cases where substantial intangible assets constitute the subject matter of a business relationship shall be laid down separately and extended in a new § 1a Foreign Tax Act. The period for potential price adjustments, among others, shall be reduced from ten to seven years following the conclusion of a transaction.

In the absence of special rules regarding the application timeline, the revised provisions governing the arm's length principle are to enter into force on the day following the Act's promulgation.

Tax Act 2020

The Tax Act 2020 was pronounced on 28 December 2020 in the German Federal Law Gazette [Bundesgesetzblatt]. The Act mainly consists of a range of minor, technical amendments and amendments in line with EU law and judgments of the European Court of Justice (ECJ) and so-called non-application laws on judgments by the German Federal Tax Court [BFH].

Overview of key elements

- **Investment deductions**: Change in eligibility requirements
- **Benefits in kind and allowances**: Definition of benefits provided "in addition to wages already owed" (additionality requirement)
- VAT: Implementation of the **EU VAT e-commerce package**

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- **Relocation of electronic accounting**: Approval requirement now only for relocation to non-member states

Investment deductions

Investment deductions allow bringing forward depreciation potential to a financial year prior to acquisition or production of tax-exempt assets. The tax-exempt investment costs are increased from 40 to 50 percent. In addition, a uniform profit limit of 200,000 euros shall apply to all categories of income in future as a prerequisite for claiming investment deductions (previously: maximum value of business assets: EUR 235,000). The amendments will already apply to tax assessment period 2020.

Benefits in kind and allowances

In response to judgments by the BFH, the so-called additionality requirement of benefits provided "in addition to wages already owed" by the employer or at the employer's instigation by a third party is to be legally defined. The additionality of such benefits is a condition for numerous tax exemptions and flat taxes, such as for job tickets or the previous tax-exempt threshold of 44 euros for benefits in kind. For income tax law as a whole it has now been "clarified" that only genuine additional benefits provided by the employer or at the employer's instigation by a third party are tax-exempt. The amendment is effective from 2020.

Moreover, the monthly tax-exempt threshold for benefits in kind (previously 44 euros) will be raised to 50 euros from 2022.

VAT: Implementation of the VAT e-commerce package

The Act transposes the so-called VAT e-commerce package, which is a component of Council Directives (EU) 2017/2455 and 2019/1995 and contains provisions to simplify taxation procedures, into national law from 2021. The original effective date was moved at EU level in response to the coronavirus pandemic from 1 January 2021 to 1 July 2021. This extends the so-called Mini One Stop Shop (MOSS) for entrepreneurs domiciled in the Community that provide certain other services to non-entrepreneurs, to a One Stop Shop (OSS) for goods supplied within a Member State via an electronic interface, intra-EU distance sales and all services provided at the place of consumption to non-entrepreneurs domiciled/residing in the Community.

Equally, the special taxation procedure for entrepreneurs not domiciled in the Community providing certain other services to non-entrepreneurs will be extended to all services provided within the Community.

An import scheme – the Import One Stop Shop (IOSS) – will be created covering distance sales of goods imported from third countries or territories to customers in the EU up to a value of EUR 150.

The amendments take effect on 1 April 2021 and will apply for the first time to revenue generated after 30 June 2021.

Relocation of electronic accounting

The relocation of electronic accounting abroad requires approval from the tax office. The German Tax Act 2020 repeals this requirement for relocation into other EU member states. Taxpayers only need to ensure that tax auditors have full data access. Approval from the tax office is then only required in the event of relocation to a non-member state. The amendments enter into force on the day after promulgation of the Act.

Draft Bill for Extension of the Tax Return Deadline

The CDU/CSU and SPD parliamentary groups have introduced a draft bill in the lower house of the German parliament (the Bundestag) to amend the Introductory Act to the Tax Code with the objective of extending the tax return deadline for the 2019 assessment period.

The draft bill states that for being able to provide proper and consistent advice, tax advisors and others in their profession must have sufficient time to do so. However, the coronavirus pandemic currently presents particular and additional challenges for members of this profession. Adherence to the statutory tax return deadline for the 2019 taxation period can no longer be ensured in many cases. For tax and assessment returns prepared by tax professionals, a longer processing period should be granted in this exceptional situation, without requiring application or bearing any consequences in the form of late filing penalties or interest.

As a solution, the draft bill provides for a six-month extension of the 2019 taxation period, which normally ends at the end of February 2021, unless the tax return was requested beforehand by the competent tax office in the individual case. At the same time, the – regularly fifteen-month – interest-free grace period of § 233a para. 2 sent. 1 Tax Procedure Act is to be extended by six months for the 2019 taxation period. This equally applies to interest on refunds and back taxes.

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Tax Group: Loss Transfer Agreement in the event of Amendment of Stock Corporation Law

A recent amendment of the German Stock Corporation Act [AktG, § 302] may require the modification of existing profit transfer agreements. This may affect all existing agreements.

Within the framework of the Act for the Expansion of Restructuring and Insolvency Law [SanInsFoG], which transposes Directive (EU) 2019/1023 on the introduction of preventive restructuring frameworks into national law, minor amendments of stock corporation law were implemented. In § 302 para. 3 sent. 2 AktG, the phrase *"or restructuring plan"* has been inserted after *"insolvency plan"*. This provision provides, particularly for profit transfer agreements, the option of (partial) waiver of the loss compensation claim of the controlled entity in the event of insolvency proceedings regarding the controlling entity's assets. The amendment refers to expansion of this regulation to the newly created restructuring plan. The expansion of § 302 para. 3 sent. 2 AktG took effect on 1 January 2021.

Establishment of a tax group for income tax purposes requires an effective profit transfer agreement. If the controlled entity is a German limited liability company (GmbH), the profit transfer agreement must include a provision on loss transfer (assumption of losses) pursuant to § 302 AktG for tax purposes. With regard to the specific wording of the loss transfer provision, the date when the profit transfer agreement was concluded is decisive.

Since the small tax group reform (concerns new profit transfer agreements that were or are concluded or amended after 26 February 2013), profit transfer agreements must include a *"reference to the provisions of § 302 AktG as amended"* (so-called dynamic reference). Existing profit transfer agreements concluded or last amended prior to 26 February 2013, need only contain *"a transfer of losses in accordance with the provisions of § 302 AktG"*.

However, the BFH ruled regarding existing legislation prior to the small tax group reform (I R 93/15, Federal Tax Gazette [BStBl.] II 2019, p. 278), that the requirement of an agreement of loss transfer in accordance with § 302 AktG also refers to those regulatory components of § 302 AktG that had not yet taken effect on the date of conclusion of the profit transfer agreement (in the case under dispute, insertion of § 302 para. 4 AktG in 2004). The BFH expressly affirmed the requirement of amendment of the profit transfer agreements concerned.

This requirement to amend existing profit transfer agreements in the event of amendment of stock corporation law should also be transferable to the recent amendment of § 302 para. 3 sent. 2 AktG taking effect on 1 January 2021. The Federal Ministry of Finance [BMF] has so far not released any statement in this respect.

This may affect all existing profit transfer agreements that were concluded with a German limited liability company (GmbH) as the controlled entity and do not contain a sufficient dynamic reference to § 302 AktG.

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