

German Tax Monthly

Information on the latest tax developments
in Germany

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Government Draft Bill for an Act on the Implementation of the ATAD

On 24 March 2021, the German Federal Government adopted the government draft bill for an **Act Implementing the EU Anti-Tax Avoidance Directive** (ATAD Implementation Act). The present draft law is intended to implement the following ATAD provisions in Germany:

- Exit taxation (Article 5 ATAD)
- CFC rules (Articles 7, 8 ATAD)
- Hybrid mismatches (Articles 9, 9b ATAD).

Compared to the ministerial draft ([see German Tax Monthly issue May 2020](#)), there are only minor fundamental changes:

- Changes to the arm's length principle under §§ 1, 1a, 1b of the Foreign Transactions Tax Law and the legal basis for advanced pricing agreements have been transferred to the draft of a Withholding Tax Relief Modernisation Act
- Reinforcing the German right to tax transferred assets:

application of the corresponding valuation only upon request

- CFC rules: delay of the first application by one year (generally as from 2022).

The other changes are mainly 'technical' in nature.

The so-called **exit taxation** is to ensure that in cases where a taxpayer moves assets or its registered office to another country, the hidden reserves can be taxed even though they have not yet been realised. The existing provisions in income and corporation tax law on exit taxation remain fundamentally unchanged.

In the reverse case of **transfer**, where a taxpayer moves assets or a corporation relocates to Germany, the principles governing the initial valuation of the transferred assets are changed. In future, the initial valuation shall correspond to the valuation in the other country. The assets shall be assessed at the value which the other country takes as tax base (there: exit taxation), however, not exceeding the fair market value.

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In cases where the German right to tax is "reinforced" (i.e. when the restriction on the German right to tax no longer applies, e.g. transfer of an asset from a foreign permanent establishment to which the tax credit method applies to a domestic permanent establishment), a withdrawal followed by an immediate contribution to the assets shall be assumed. Here also, the valuation abroad, but at most the fair market value, shall be relevant. Any resulting gain on withdrawal shall be taxable by crediting or deducting foreign tax. This provision is designed as an option in the government bill, in that it only applies at the request of the taxpayer. If the taxpayer does not submit an application, no hidden reserves are disclosed domestically (in Germany) if the foreign country applies a higher value than the German book value in its exit taxation. At the same time, however, no additional depreciation potential is generated in Germany.

The government bill does not provide any particular timeframe for applying the new regulations. The new regulations shall enter into force on the day after their promulgation.

The amendments of the **CFC rules** are essentially unchanged compared to the ministerial draft bill. They shall first be applicable for the assessment or tax collection period for which intermediary income is to be added that accrued in a fiscal year of the intermediary company **commencing after 31 December 2021**.

The lower house of the German parliament (Bundestag) must pass the draft bill before the end of the legislative period; that means before the constituent meeting of the new Bundestag after the federal elections on 26 September

2021, otherwise the draft bill is subject to discontinuity. The final scheduled meeting week of the Bundestag is set for the week from 21 to 25 June 2021.

BMF Guidance on German CFC Rules – Expanding the Motive Test to Third Country Situations

The German CFC rules are not applicable however if the shareholder can prove that the foreign company engages in an actual economic activity and there is an extensive exchange of information between Germany and the foreign country ("motive test").

The motive test has been restricted to EU/EEA companies thus far. The BMF guidance dated 17 March 2021 now extends the motive test to third-country companies. The background to this is the European Court of Justice (ECJ) ruling of 26 February 2019 (C-135/17), according to which the German CFC rules may unjustifiably restrict the free movement of capital with regard to third-country companies.

Pursuant to the BMF guidance, the following must be substantiated in order to demonstrate a real economic activity:

- Participation in foreign market activity is constant and lasting
- The company is not only equipped appropriately in terms of personnel, but also with respect to material
- Its main economic activity is not provided by third parties
- The participation in the foreign company is not purely an artificial arrangement

- There are valid business (i.e. non-tax) reasons for participating in the foreign company

Furthermore, it can be refrained from applying the German CFC rules also in third country situations only when there is an extensive exchange of information between Germany and the third country.

Extending the motive test is applicable to all cases that are not yet final.

BMF Guidance on Continuation-linked Loss Carryforward

The German Federal Ministry of Finance [BMF] issued application guidance on continuation-linked loss carryforward on 18 March 2021.

Transferring shares in a German corporation may result in forfeiture of its unused loss carryforwards under certain circumstances (so-called detrimental change in ownership pursuant to § 8c CIT). The loss carryforwards are retained in the amount of available hidden reserves (so-called hidden reserves clause). In 2018, a regulation on the so-called continuation-linked loss carryforward has been inserted by way of § 8d CIT. Accordingly, forfeiture of loss carryforwards does not occur despite a detrimental change in ownership, if certain conditions are met.

According to § 8d CIT covers all unused loss carryforwards within the meaning of § 8c CIT as well as interest carryforwards (under the thin capitalization rule) of corporations with resident and non-resident tax status. § 8d CIT and, therefore, the principles of the above-mentioned BMF guidance apply accordingly to trade tax deficits of corporations.

With regard to application of the hidden reserves clause or § 8d CIT, there is a right to choose according to the BMF guidance, but the two exceptions cannot be combined. If the hidden reserves are insufficient to fully retain the existing loss carryforwards, the remaining losses at risk of non-deductibility cannot therefore be carried forward in addition by means of an application pursuant to § 8d CIT.

The key requirement for using § 8d CIT is "the same business operations": the corporation must maintain exclusively the same business operations for a certain period of time before the detrimental change in ownership occurs, continue these business operations also after the change in ownership, and a detrimental event must not lead to a change in business operations.

With regard to the requirement "maintaining the same business operations", the BMF guidance takes an activities-based approach (segmentation). Accordingly, a corporation has several business operations if it pursues several independent activities. Whether there are several independent activities depends on whether the respective activities are distinct based on qualitative criteria (products/services on offer, customers/suppliers, staff qualification). If there are several business operations, § 8d CIT does not apply. The BMF guidance contains two exceptions with regard to the activities-based approach:

- **Exception in the event of operation as a single business operation:** if the independent activities are mutually dependent or mutually support each other as principal and ancillary activity and create significant synergistic effects.

- **Additional other practised activity:** non-detrimental if the net revenue does not exceed 3% of the total net revenue of the loss-making operation and the amount of EUR 24,500 in the assessment period.

The guidance also contains statements regarding detrimental events and legal implications. § 8d CIT is effective for detrimental change in ownership after 31 December 2015, if business operations were neither discontinued nor suspended prior to 1 January 2016. This also applies to non-calendar financial years ending in 2016. Application is possible regardless of earlier discontinuation or suspension of the business activities if the losses were incurred after 31 December 2015.

BMF Guidance on Useful Lives of Computer Hardware and Software

The German Federal Ministry of Finance [BMF] issued a guidance on the useful lives of computer hardware and software in its guidance dated 26 February 2021. **One year** can be applied as the useful life with a view to the "rapid technical progress" in the area of digitalisation. Thus, the BMF makes it possible to immediately write off certain "digital" assets.

The tax authorities adjust the useful lives of computer hardware and software, which are to be used for tax depreciation and amortisation, in line with the "changed actual circumstances". The tax authorities will assume in the future a useful life of one year for the assets referred to in more detail in the BMF guidance. According to the BMF guidance dated 18 November 2005, the useful lives for computers and similar equipment thus far – based on the tax depreciation table –

were three years for general fixed assets and five years for business software systems (ERP software). It is therefore possible to immediately write off computer hardware and software in the year of acquisition or production.

The term "computer hardware" includes, among other elements, computers, desktop computers, notebook computers (including tablets, slate computers, mobile thin clients), mobile workstations and peripheral devices.

The assets are defined individually in the BMF guidance. In this regard, the BMF draws on the definitions in Regulation (EU) No 617/2013 dated 26 June 2013 with regard to "ecodesign requirements for computers and computer servers". According to the BMF guidance, the hardware products specified under items 1 to 7 are only recognised under the condition that information is to be provided by manufacturers pursuant to Annex II of the above-mentioned EU Regulation, according to which the product type is to be provided in the technical documentation ("ecodesign requirements" for computers). Listing computer hardware according to items 1 to 7 is therefore final.

"Peripherals" are subdivided into input devices (e.g. keyboard, mouse, scanner, digital camera, microphone, headset), external storage (e.g. hard disk; DVD/CD drive, USB stick) and output

devices (e.g. speaker, monitor, display, printer). Peripherals are to be identified in close alignment with the listed devices. This list is, however, not exhaustive.

The term "software" includes operating and user software for data entry and processing. Besides standard applications, this also includes applications customised for individual users, such as ERP software, software for merchandise management systems or other application software for business management or process control.

These rules apply for the first time to financial years ending after 31 December 2020. The BMF guidance can also be applied to corresponding assets that were acquired or manufactured in previous financial years and for which a useful life other than one year was used as a basis. Thus, the residual book values can also be written off in full in financial year 2021. For private assets (such as home office equipment) that are used to generate income, the above-mentioned guidance applies accordingly from tax assessment period 2021.

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