On 25 June 2018, the German Ministry of Finance (MOF) published a draft of the Annual Tax Act 2018, which is expected to be legislated in the third and fourth quarter of 2018. The following selected items of the draft are of particular relevance for business taxpayers:

**Taxation of capital gains realized by nonresident taxpayers upon the disposition of shares in “land-rich” corporations**

**Current law:** Nonresident taxpayers are only taxed on capital gains realized upon the disposition of shares in a German resident corporation, if the taxpayer held an interest of 1% or more in that corporation at any time during the five years preceding the disposition.

**Proposed law:** The above ruled will be flanked by imposing a capital gains tax on the disposition of shares in any German resident or nonresident corporation, which is a “German land-rich” corporation. A corporation is defined as a land-rich corporation if the value of its shares is, at any point in time during the 365 days preceding the disposition, more than 50% based on German real estate, and the shares were at such point in time attributable to the taxpayer. In addition, the capital gains taxation was extended to the disposition of shares in any resident or nonresident German land-rich company, where the taxpayer owned less than 1% at any point in time prior to the disposition.
Under the effective date and transition rules, only share dispositions occurring after 31 December 2018 will be taxed, and taxation will comprise only the capital gain which is attributable to the share appreciation accumulated after 31 December 2018.

The proposed statute is aligned with Art 13 (4) of the Organisation for Economic Co-operation and Development (OECD) model treaty, which allows in principle the real estate jurisdiction to tax such gains. The current German model treaty, and most modern German tax treaties follow Art. 13 (4) of the OECD model treaty, although in some cases with individualized limitations and special rules, so that the tax treaty position of each nonresident shareholder must be confirmed to determine the actual impact of the new statute on the investment.

In addition, one should note that any share gain realized by a resident or nonresident corporate shareholder is in principle exempt under overarching corporate tax act rules (exceptions apply for certain shares held directly or indirectly by regulated financial institutions or life and health insurance companies). Although the capital gain exemption rules stipulate, that the corporate taxpayer has to include an amount of 5% of the capital gain as a “deemed non-deductible expense” in taxable income (reducing the exemption effectively to a 95% exemption), the German Federal Fiscal Court decided recently that the 5% income inclusion does not apply to a nonresident corporate shareholder (unless the shares were allocable to a German permanent establishment of such nonresident shareholder). The German tax authorities accepted that verdict and published it in the *Federal Tax Gazette*, and as a consequence and until a further change in law, any share gain realized by a nonresident corporation should be currently 100% exempt, regardless of whether a disposition of shares in a German land-rich corporation is concerned.

**Amendment of the change in ownership limitation rules**

**Current law:** Pursuant to Sec. 8c (1) S. 1 of the Corporate Income Tax Act (CITA), the transfer of a greater than 25% (but not exceeding 50%) ownership interest in a loss corporation to one acquirer during a period of five years results in a prorated forfeiture of the loss attributes (loss carryforwards, current losses and interest carryforwards) of the corporation. That is, e.g., if 26% was transferred, 26% of the loss attributes are forfeited. However, in March 2017, the German Constitutional Court held that Sec. 8c (1) S. 1 CITA violates German constitutional principles and should not apply to any transfers which occurred since the inception of the law (1 January 2008) until 31 December 2015. The court obliged the German legislator to change the law with retroactive effect until 31 December 2018. The Constitutional Court chose 31 December 2015 as the end date, because after that date, the effects of Sec. 8c (1) S. 1 CITA were ameliorated by new Sec. 8d CITA, which included a “continuity in business” exception framework (no loss attribute forfeiture if, under a rather narrow set of rules, the loss company continues its historic loss business).

**Proposed law:** Sec. 8c (1) S. 1 CITA does not apply on any 50% or smaller ownership change which took place prior to 31 December 2015.

With this proposal, the MOF has chosen the most efficient way to comply with the 2017 judgment of the German Constitutional Court. As it is, the new rule will apply only to pre-2016 transfers in still open cases. Note that another case challenging the validity of Sec. 8c (1) S. 2 CITA, which governs ownership changes above 50% (which result in a 100% forfeiture of all loss attributes) is still pending at the Constitutional Court.

**German Consolidated Group Taxation Regime (Organschaft) changes**

**Current law:** In a German consolidated group, the subsidiary must transfer its entire annual income on the basis of a so-called profit and loss transfer agreement. A minority shareholder of the subsidiary is, under German corporate law, entitled to a “guaranteed compensation payment” (*Ausgleichszahlung*). Sec. 14 (1) CITA, regulations thereunder, stipulate that such compensation payment must be a “fixed” payment (based on past and expected income of the company), and cannot include a variable component which is pegged to the actual income of the company. In spite of this, German tax authorities did not treat variable components as harmful in all cases in the past. However, in a recent case, the German Federal Fiscal Court held that any variable components should be harmful and result in a failed tax consolidation.

**Proposed law:** The intention of the proposed law is to mitigate the effect of the new court case to the benefit of the taxpayer. The minority shareholder may, in addition to a “fixed” minimum compensation payment, obtain a variable component. However, the entire compensation payment must not exceed the pro rata share of the subsidiary’s income, which is allocable to the minority shareholder’s interest.
In addition, the portion of the guaranteed compensation payment which exceeds the “fixed” amount must be “from the perspective of a rational businessman considered to be economically reasonable.”

The “economically reasonable” test injects a “soft” element into the proposed statute which may deter taxpayers from utilizing the newly proposed rule. Consequently, it remains to be seen whether it will gain practical relevance.

The proposed rule should apply retroactively in all open cases.

**Value Added Tax (VAT) Act: Secondary VAT liability for operators of e-commerce platforms**

**Current law:** No specific rules for operators of e-commerce platforms.

**Proposed law:** Operators of e-commerce platforms (“electronic marketplaces” in the parlance of the statute) are subject to comprehensive compliance obligations concerning specific information details, which have to be collected from each platform seller/supplier qualifying as entrepreneur for VAT purposes. A platform operator is widely defined as any person or entity operating a website or other internet based instrument which promulgates information enabling a third party to carry out (sale/supply) transactions. Note that it is not required that the platform operator is resident in Germany. The platform operator must collect for any transaction, where the transport of a good either commenced or ended in Germany the following:

• Name and address of the supplier/seller
• Tax registration and, if issued, VAT registration number of the supplier/seller
• Issue and expiration date of the seller’s/supplier’s “certificate of registration” (to be issued by the seller/supplier tax office for a period of up to three years. The issuance will be recorded in an electronic database, which is accessible to the operator. The tax office will deny the issuance to sellers/suppliers who were non-compliant or are expected to be non-compliant with their VAT filing and payment obligations. Sellers/suppliers resident outside the European Union or European Economic Area have to appoint a tax representative)

• Pick up location for the transport of the sold item and location of delivery
• Date and time of the sale transaction and realized amount

The e-commerce operator is liable for any unpaid VAT of the seller, unless the operator can prove that there was reasonable basis to assume that the seller complied with its VAT obligations. Such exculpation will not be possible, if the abovementioned seller’s “certificate of registration” was not made available to the operator. A secondary liability of the operator will also be triggered for any sales of a seller, which has been specifically flagged by the tax office (to the operator) as a non-VAT compliant seller.

For transactions of sellers who did not register as VAT entrepreneurs with the market place operator, no secondary liability of the operator for unpaid seller VAT will be triggered, if the operator was compliant with the collection of the remaining information details. This will be not the case, however, if the operator could or should have, in light of the nature, frequency and magnitude of the seller’s transactions, reasonably concluded that the seller should qualify as an entrepreneur for VAT purposes.

**Other changes and legislative procedure**

In addition, the *Annual Tax Act 2018* includes a number of smaller changes and “housekeeping” amendments to various items of the *Income Tax Act*, the *Investment Tax Act*, and the *VAT Act*. It is expected that the legislative hearings and final enactment of the law will be completed in 2018. In the final Act, any of the above described proposals may be included in a substantially modified form, so interested taxpayers should monitor the further developments of the legislative proceedings.
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