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Germany announces unilateral Pillar 2 implementation

Germany and other EU states confirm their intention to proceed with minimum taxation

Content

As part of an energy cost relief package and despite the ongoing negotiations on EU level, the German Federal Government unexpectedly announced on 4 September 2022 that Germany will start the Pillar 2 implementation.

The Federal Government will now start on a domestic level with the implementation of the internationally agreed global minimum taxation. The tax will lead to additional revenues amounting to billions in the long run.

Coalition officials later added that the Federal Ministry of Finance will publish a draft German Pillar 2 implementation bill by the end of 2022 and independently of the outcome of the next ECOFIN meeting. This bill will likely follow the draft EU directive with no deviations on major issues. Assuming that the EU will sooner or later agree on an EU-wide Pillar 2 directive and the German legislative process would not be finished before early 2023, Germany would finally implement Pillar 2 on an EU law basis. ▸

Germany announces unilateral Pillar 2 implementation

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On 9 September 2022, only five days after the German relief package, Germany's position was supported by a joint statement of Germany, France, Italy, Spain, and the Netherlands. In the statement, all five EU member states committed to implementing Pillar 2 in 2023 ''by any possible legal means''. The statement is a sign that these countries, five of the biggest economies of the EU, are willing to implement Pillar 2 in a smaller group if no agreement is reached among all Member States. The implementation could happen either through the so-called enhanced cooperation procedure or through informal coordination of national bills.

On EU level, negotiations on the Pillar Two Directive and efforts to persuade the last veto country Hungary have continued over summer. However, there are no signs that Hungary will drop its veto at the next formal ECOFIN meeting on 4 October 2022. It remains to be seen if the joint statement may trigger a domino effect of unilateral implementation of Pillar 2 across the EU, regardless of progress in reaching unanimity at an EU level.

In this context, an EU Council representative indicated that the compromise text as agreed before the summer break will not change anymore. This will allow unilateral, coordinated implementation by EU Member States, while in parallel formalization of that agreement may be reached through enhanced cooperation or Hungary also joining the agreement on the compromise text.

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Relief package to address high energy prices announced

In the light of surging energy prices, the federal coalition announced a comprehensive relief package consisting of roughly 20 measures to reduce the burden on German households and businesses. Some key measures of the package are:

- Germany will implement a new regulation of the electricity market in order to reduce and redistribute excess profits of certain electricity producers. Meanwhile the EU Commission has published a proposal to implement a temporary revenue cap on certain electricity producers as well as a temporary solidarity contribution on excess profits generated from activities in the oil, gas, coal and refinery sectors. If adopted, this EU proposal would allow Germany to implement the planned redistribution instrument in coordination with its EU partners.
- For energy-intensive businesses, the peak equalization in energy tax and electricity tax will be extended to 2023.
- VAT on natural gas will be reduced to 7 percent from 1 October 2022 to 31 March 2024.
- The CO_2 levy will not be increased on 1 January 2023, the increase will be postponed by one year.
- The personal income tax brackets will be adjusted to the high inflation rates as of 2023.

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New 1.8 percent interest rate on tax arrears and refunds

The legislative process regarding the Second Act to Amend the Fiscal Code and the Introductory Act to the Fiscal Code (Interest Rate Act) is completed and the bill was published in the Federal Gazette on 21 July 2022. The bill introduces a retroactive interest rate of 1.8 percent for interest on tax arrears and refunds for interest periods beginning on or after 1 January 2019. The new interest rate generally does not apply to other cases of interest related situations under the German General Tax Code, individual tax acts, or late payment fines.

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German Government releases draft of Annual Tax Act 2022, raising hope for a change in the German extraterritorial tax rules for IP registration cases

A Government draft bill of 14 September 2022 proposes to eliminate in most cases the nonresident taxation of certain royalty income and capital gains relating to rights solely because these rights are registered in a public German book or register. In this regard, the Government draft bill of the Annual Tax Act 2022 is in line with the first draft bill that was published on 28 July 2022. Our *Global Tax Alert dated 28 July 2022* provides an overview of the most relevant proposed changes. It is planned to finish the legislative process by the end of 2022.

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The Act on the Introduction of Virtual General Meetings of Stock Corporations

A significant change implemented during the COVID-19 pandemic for stock corporations (Aktiengesellschaften, AG) was the possibility of having general shareholder meetings in virtual form. Based on the experience gathered from these special rules during the Corona pandemic which expired on 31 August 2022, the legislator decided to permanently provide stock corporations with this possibility.

The amendment to the German Stock Corporation Act (Aktiengesetz, AktG), which came into force in July 2022, now creates the legal basis for the permanent possibility of holding general meetings virtually. The aim of the Act is to harmonize the requirements of company law with the ongoing digitalization in the best possible way and thus to achieve a modern development of company law.

The most important part of the new regulations is the newly introduced provision of sec. 118a AktG, which defines a virtual general meeting as a "meeting without the physical presence of the shareholders or their proxies" and establishes certain requirements that a virtual general meeting must fulfil. Accordingly, the basic prerequisite for holding a virtual general meeting is that the possibility thereof is provided for in the company's articles of association. Further, the entire general meeting must be broadcasted in video and audio and it must be ensured that the shareholders can exercise their right to vote, to propose motions, to receive information, to speak and to object.

The new regulations do not only affect the course of the general meeting itself, but also the preparatory phase before the meeting. The option already granted in the expired COVID-19 legislation to submit questions in advance of the virtual general meeting has been adopted and specified to the extent that the Board of Directors can now determine that ▸

such questions must be submitted no later than three days before the general meeting (sec. 131 para. 1a AktG). Further, these questions must be published and answered no later than one day before the general meeting (sec. 131 para. 1c AktG). The Board of Directors has the option to limit the right to ask questions in advance to those shareholders who have duly registered for the meeting as well as to limit the number of questions asked in advance (sec. 131 para. 1b AktG).

One innovation compared to the expired COVID-19 legislation is the right of shareholders to submit statements to items on the agenda in advance of the virtual general meeting (sec. 130a AktG), as already offered by individual companies on a voluntary basis. Such a statement must be submitted no later than five days before the meeting. Similarly as for the right to ask questions, the right to submit statements may be limited to shareholders who have duly registered for the general meeting.

In order to prevent technical disruptions, in particular on the part of a shareholder entitled to speak, in the interest of the company and all other shareholders in an orderly course of the meeting, the law offers the possibility to check the functionality of the video communication between a shareholder and the company prior to speaking and to reject the speaking after failing this test (sec. 130a para. 6 AktG).

According to the explanatory notes to the law, experience during the COVID 19 pandemic has shown that the virtual meeting format can lead to higher participation, that an increase in the number of questions asked can be observed due to the earlier granting of the right to information, and that the answers to these questions are of higher quality due to the correspondingly longer response time. Now it remains to be observed whether this possibility will actually be used in practice and whether these positive experiences will continue.

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German Federal Ministry of Finance publishes draft DAC7 implementation bill

The Directive of Administrative Cooperation (DAC) regulates the exchange of tax information within the European Union. It is regularly updated. The latest update obligates platform operators with due diligence procedures and reporting requirements. Our *EY Global Tax Alert dated 25 July 2022* provides an update of the German implementation of this latest DAC update (DAC7).

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New German ordinance on business function relocation

On 6 July 2022, the German Ministry of Finance (BMF) published a draft bill for the amendment of the German Ordinance on Business Function Relocation (Funktionsverlagerungsverordnung, FVerlV). The FVerlV is to be revised with retroactive effect from the beginning of 2022.

The main reason for the amendment of the FVerlV is the incorporation of legislative changes made by the German Withholding Tax Relief Modernization Act (AbzStEntModG) that came into force at the beginning of the year. In that bill, the legislator has anchored the provision on the relocation of business functions in a new sec. 1 para. 3b Foreign Tax Act (FTA) with effect from 1 January 2022 and legally defined the transfer package for the first time. According to the revision of the law, the taxpayer should only have the opportunity of a single asset valuation instead of the transfer package approach if it can be credibly demonstrated that neither significant intangibles nor other benefits have been transferred (e.g., relocation of routine business functions). To this extent, the scope has been expanded, as previously a single asset valuation was only not possible if significant intangibles and other benefits were transferred simultaneously. Besides, the two other so-called "escape clauses" that were previously available are no longer applicable.

According to its explanatory memorandum, the draft bill is essentially intended to contain editorial adjustments to the existing FVerlV and to adapt the ordinance to the amended legal situation. This is misleading insofar as the present draft also contains some more far-reaching changes that go beyond the necessary measures specified by the legislative changes:

- Among other things, the FVerlV now explicitly demands that tax effects resulting from the relocation of business functions itself have to be considered when determining the agreement range from which the value of the transfer package is determined. This usually leads to a higher bargaining range and thus, a higher arm's length price.

- Furthermore, the risk surcharge for determining the capitalization interest rate should no longer be based on standard company comparison parameters, as it has been the case to date, but has to be measured based on comparable cases between third parties for both the acquiring and the transferring company. This means that going forward the taxpayer would have to determine interest rates based on third party risk surcharges for comparable functions which are not readily available and can no longer refer to internal company practice.

- In addition, the draft bill provides for a change in the burden of proof to the detriment of the taxpayer in several instances, e.g., regarding the discount period (indefinite vs. definite), the question of whether a transfer of function actually took place and with regard to the question whether third parties would have limited consideration to contractual compensation claims. According to the previous regulations in the FVerlV it was sufficient that the taxpayer presented reasonable arguments for his positions. Under the new rules, the taxpayer has to provide evidence. This gradual but significant change is not in line with general tax principles governing German tax law and further shifts the burden of proof to the taxpayers.

The suggested changes, if implemented, will not only lead to additional administrative burden for the taxpayers but will also increase the risk of double taxation in case of business restructurings since it can be expected that the very specific German rules will not be accepted by other tax authorities without challenges.

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BMF issues official guidance on withholding tax for software development services

The withholding tax treatment of remuneration in connection with software purchases or software development – even after a basic classification of the payments was made by the Ministry of Finance (BMF) guidance dated 27 October 2017 – repeatedly gives rise to discussions between remuneration creditors and remuneration debtors regarding the obligation to withhold tax pursuant to sec. 50a (1) no. 3 German Income Tax Act (ITA). The discussions center around whether transactions should be viewed as a final transfer of a right or as a (temporary) license to use a right for a limited period of time, as only the latter gives rise to withholding tax under domestic law. Following a change in the German Copyright Law, this question has now been addressed by tax authority guidance. In the opinion of the BMF, an economic purchase of rights (which is not subject to withholding tax) should from the date of the law change in principle be possible – even if the copyright still cannot be legally transferred. The BMF explains this with the fact that since the amendment of the Copyright Law, it is possible in principle to transfer the legal position in computer programs in such a way that no further economic position remains with the author. However, it depends decisively on the details of the contractual provisions as to whether they provide for the granting of comprehensive, exclusive and irrevocable rights of use and exploitation to the computer program for an unlimited period of time, so a case-by-case review of the individual contracts would be required to assess whether a payment under a software development contract triggers withholding tax.

The principles of the guidance shall apply to all payments made after 6 June 2021. The BMF does not explicitly comment on the tax treatment of payments prior to that date. However, the comments in the tax authority guidance suggest that the tax authorities would view these payments as subject to withholding tax. For more details, please refer to the *EY Global Tax Alert dated 22 August 2022*.

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BMF circular dated 20 May 2022 – VAT exemption for intra-Community supplies

The Federal Ministry of Finance (BMF) has softened its strict requirements for the EC Sales List as a prerequisite for the VAT exemption for intra-Community supplies. Background of this decision is that with effect from 1 January 2020, the requirements for the VAT exemption of intra-Community supplies have been tightened and the BMF has accordingly amended the German VAT guidelines.

An intra-Community supply is given when goods are transported from one EU Member State to another EU Member State. According to the German VAT Act an intra-Community supply is VAT exempt in Germany. But this does not apply if the supplier has not properly submitted an EC Sales List or has not declared the supply in question or has declared the supply incorrectly.

In this context, the BMF previously took the view that the conditions for the VAT exemption of an intra-Community supply are not met if the taxable person does not submit an EC Sales List correctly, completely or in due time. This means that the BMF was of the opinion that the VAT exemption of an intra-Community supply is not given in the mentioned cases and has set down this view in the German VAT guidelines. Inter alia the tax authorities denied the VAT exemption of the intra-Community supply in case of late submission of the EC Sales List.

German tax authorities

Especially with the requirement of timely submission, the BMF went beyond the wording of the German VAT Act. The VAT Directive, which is basis for the German VAT Act, does not set out any time limit in this respect. On the basis of its recent decree of 20 May 2022, the BMF removed the requirement to submit an EC Sales List in due time from the German VAT guidelines. Instead, the exemption of the intra-Community supply can be achieved with retrospective effect by submitting the correct and complete EC Sales List (also if this is done at a later point in time after the initial EC Sales List turns out to be wrong or incomplete). The aforementioned changes apply to all intra-Community supplies made after 31 December 2019.

However, it should be noted that as long as the EC Sales List is not submitted, incorrectly or incompletely submitted, the tax authorities can still deny the VAT exemption of the intra-Community supply. Furthermore, even though this failure can be corrected with retrospective effect for the VAT exemption, a late submission of a correct EC Sales List can be sanctioned with a fine procedure by the German Federal Tax Office.

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Tax authorities confirm court decisions on US spin-offs for private investors

In a series of similar cases (in particular, VIII R 9/19 and VIII R 15/20 dated 1 July 2021), the Federal Tax Court (BFH) ruled that a spin-off carried out under US law was comparable to a German spin-off. The decisions allowed for a tax neutral allotment of new shares replacing the old shares at the level of the individual shareholders. Although this decision was opposed to the previous view held by the tax authorities, the German Ministry of Finance (BMF) has now confirmed the court's view; however, only for private investors.

Generally, the share allotment in the context of a spin-off leads to a taxable capital gain for the German shareholders in the form of a distribution in kind. In the case of portfolio (free float) shares, however, a tax neutral roll-over is allowed if the transfer of the shares takes place in the context of a spin-off (Abspaltung) to another corporation. In the aforementioned court cases, the BFH decided that the roll-over regime for free float shares does not only apply to German but also to foreign spin-offs. Moreover, the court stated that a foreign spin-off is comparable to a German spin-off even if the asset transfer does not occur as a partial universal succession but by way of singular succession. The decision was driven by the right for free movement of capital in conformity with EU law which must also apply to foreign transactions. In the relevant cases, the free movement of capital was applicable because the shares were free float.

In an update of its public letter ruling regarding private capital income on 19 May 2022, the BMF has now confirmed the court's view, which means that it is now generally applicable to similar fact patterns in other cases. The decree refers to a list of comparability criteria that must be fulfilled to apply the tax neutral roll-over regime; universal succession is not a relevant criterion any longer. However, through another public letter ruling issued on the same day, the authorities have made clear that this interpretation only applies to free float shares held by private investors. A spin-off involving corporate shareholders or individual investors holding their shares as business assets must still occur by way of (partial) universal succession as one relevant feature for legal comparability to a German spin-off. Otherwise, according to the authorities, such reorganization may not enjoy the respective tax benefits offered by sec. 15 of the German Reorganization Tax Act.

Consequently, the public letter rulings may present good news to private investors holding shares in, e.g., US entities that intend to carry out a spin-off under US rules. On the other side, for corporate investors engaging in US spin-offs under singular succession, the decrees dash any hopes for a wider interpretation of the underlying court decisions. Such investors will still need to apply different restructuring steps in order to obtain tax neutrality.

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Decrees on the application of sec. 1 para. 2a and para. 2b RETT-Act

The legislative amendments by the reform of the Real Estate Transfer Tax Act (so-called share deal regulations), are in principle to be applied for the first time to acquisition transactions that are realized after 30 June 2021. Due to numerous questions regarding the application of the new provision of sec. 1 para. 2b of the German RETT-Act (change of ownership in real estate corporations) and the relationship of the provision to the existing sec. 1 para. 2a RETT-Act (change of ownership in real estate partnerships), the decree on sec. 1 para. 2b RETT-Act was eagerly awaited. The supreme tax authorities of the federal states have also revised the existing decree on the application of sec. 1 para. 2a RETT-Act with regard to the following points:

According to the decrees, the real estate belongs to the company to which it is attributable under RETT law. This is the case if the real estate is attributable to the company for real estate transfer tax purposes at the time the tax arises due to an acquisition transaction falling under sec. 1 para. 1, 2, 3 or 3a RETT-Act. Thus, there is a risk of multiple taxation of a property by attribution to several companies.

The status as a former shareholder is only retained in the case of an indirect shortening of the chain of shareholdings.

The so-called "change of legal form concept" is prevented by the fact that relevant changes of shareholders in the company changing its legal form are also deemed to be changes of shareholders to be recorded after the change of legal form under certain conditions.

According to the decrees, sec. 1 para. 2a and sec. 1 para. 2b RETT-Act are of equal rank. There is no precedence. Disadvantages could result from this, in particular with regard to the simultaneous realization of both facts and a factual elimination of the crediting of the tax pursuant to sec. 1 para. 6 RETT-Act that could end in double or multiple taxation.

According to the decrees, the transaction under the law of obligations (signing) and the legal transaction in rem, i.e. the transfer of the shares (closing), constitute two separate transactions under RETT law. Therefore, according to the decrees, a determination must be made at the time of signing and at the time of closing. The assessment about the signing shall always be made subject to review and shall be revoked or amended as soon as the notice about the closing is issued and insofar as the property is identical.

In the decree on sec. 1 para. 2b RETT-Act, the administration did not comment on share transfers where the signing took place before 30 June 2021 and the closing after 1 July 2021. The identical decree of sec. 1 para. 2b RETT-Act also does not contain any statements on the application of the stock exchange clause of sec. 1 para. 2c RETT-Act. According to reports, a separate decree is currently being drafted in this regard.

Another significant change concerning the identical decrees on the application of sec. 1 para. 2a RETT-Act is the deletion of the so-called perpetuity clause, which has long been criticized in literature. Thus, in the case of indirect changes of shareholders in a corporation, which in turn holds shares in a real estate-owning partnership, the five- respectively ten-year period applies.

The decree on the application of sec. 1 para. 2a RETT-Act is to be applied in all open cases. For transactions that are realized before 1 July 2021, the decree generally applies with the proviso that the participation limit of 95% and a five-year period are to be applied. The decree on the application of sec. 1 para. 2b RETT-Act only refers to periods after the statutory introduction of sec. 1 para. 2b RETT-Act, i.e. to all open cases after 30 June 2021.

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Installment payments: Tax point and the meaning of partial supplies in this context

In general VAT is due when the supply of goods or services has been performed. It is irrelevant whether the customer has already paid the remuneration at that time. If the agreed remuneration for a taxable transaction has become uncollectible – fully or partially –, the tax base amount is reduced to the collectible part of the remuneration (sec. 17 para 1, 2 German VAT Act).

According to the judgment of the Federal Tax Court (BFH, case reference V R 37/21 (V R 16/19), 1 February 2022), the non-payment of part of the remuneration before its due date in the case of an installment agreement cannot be classified as uncollectibility of the remuneration in the sense of sec. 17 para 1, 2 German VAT Act. Therefore, the tax point of the pertaining VAT is in the period when the supply was performed (regardless that the consideration is not yet collected). As a result, suppliers must pre-finance the VAT owed for one-off supplies of goods or services for which payment is made in installments.

The consequences of this decision for so-called security retentions in the case of warranty claims, for which the BFH has affirmed the application of sec. 17 para 1, 2 German VAT Act (BFH ruling dated 24 October 2013, case no. V R 31/12), remain to be seen. Currently such retentions are interpreted as uncollectible in the interim and VAT becomes due only later when these amounts are released and actually paid. This may change in future based on the new case law.

Furthermore, the BFH has commented on the interpretation of the concept of partial supplies (sec. 13 para. 1 no. 1 lit. a sentence 3 German VAT Act). In general, a partial supply is deemed to exist if the remuneration for certain parts of an economically divisible supply is agreed separately. For partial supplies, VAT is due at the time the partial supply has been performed. The BFH is of the opinion that this can only be the case for supplies of a continuous and recurring nature. This requirement is not already met per se if installment payments for one-off supplies are agreed.

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Federal Tax Court on exit taxation for gift of shares in real estate rich company

German exit taxation applies in case of a gift of privately held shares to an individual who is not a German tax resident. According to the Federal Tax Court (BFH, judgment of 8 December 2021, I R 30/19), this applies even if the German taxing right is not restricted or excluded after the gift.

German exit tax is of relevance for individuals who have been German tax residents for at least seven years out of the last 12 years, see sec. 6 of the German Foreign Tax Act (AStG). In scope are all German or non-German shareholdings in corporate entities of 1% or more. Exit tax is mainly triggered upon the termination of the German tax residency, when the individual gives up place of residency (Wohnsitz) and/or habitual abode (ständiger Aufenthalt) or is considered a non-German tax resident under a double taxation treaty. The result would be a taxation of the built-in gains in the relevant shares at up to 28.5%.

In addition, exit tax can also be triggered when the shareholder transfers the shares to an individual or entity which is not a German tax resident, in particular by way of inheritance or gift (sec. 6 para. 1 no. 2 AStG). It was so far unclear whether this also applies in case that Germany may still tax the potential sale of the shares after the gift or inheritance under an applicable double taxation treaty. This can be the case if shares in a "real estate rich company" are transferred, where the assets of the company consist predominantly of German real estate. ▸

The BFH now answered this question in the positive with regard to the AStG as applicable before 2022, which should also be of relevance for the currently applicable law:

First of all, the wording of the law expressly does not provide for a requirement of the exclusion or restriction of the German taxing right and, according to the BFH, this cannot be interpreted into the wording either.

The BFH also denied a restrictive interpretation from a constitutional law point of view, since there was an abstract risk of a reallocation of assets in the real estate rich company after the gift which could lead to a restriction or exclusion of the German taxing right under the treaty. The court states that an individual who is not a German tax resident (such as the recipient in the case at hand) is not in scope of the German exit tax and this was seen as a reason that allows for a direct taxation of the built-in gains at the time of the gift.

Finally, the BFH also rejected the restrictive interpretation put forward from the point of view of EU law with regard to the free movement of capital affected by the exit tax with reference to the so-called standstill clause (Art. 64 of the Treaty on the Functioning of the EU).

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Economic view in the case of a reduction in the shareholding in a joint ownership

If real estate is transferred from one joint ownership to another joint ownership, the German RETT is not levied insofar as the shares of the joint owners in the assets of the acquiring joint ownership correspond to their shares in the assets of the transferring joint ownership (sec. 6 para. 3 sent. 1 in conjunction with para. 1 sent. 1 RETT-Act). However, if the share of the joint owner in the assets of the acquiring joint holding decreases within five (as of 1 July 2021 ten) years after the transfer of the real estate, this tax exemption ceases to apply retroactively (sec. 6 para. 3 sent. 2 RETT-Act).

According to the German Federal Tax Court (BFH), such a detrimental reduction in the shareholding occurs if the shareholding in the assets of the joint holding is reduced (BFH ruling of 12 January 2022, II R 4/20). This can occur through the sale of the share in the company itself or through other agreements. In the case of any other agreement, it is decisive that, from an economic point of view, the participation in the economic value of the share in the company and thus the participation in the value of the contributed property is reduced. In this respect, the BFH no longer adheres to its previous opinion according to which, in terms of sec. 5 and 6 RETT-Act, the in rem (civil law) co-entitlement of the joint owners to the company assets is decisive as the connecting factor. Therefore, a different agreement can lead to a reduction in the share even if the civil law participation in the joint ownership assets is otherwise unchanged.

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Federal Tax Court decides again on cross-border group financing

On 13 January 2022, Germany's Federal Tax Court (BFH) decided again on the deductibility of write-downs of unsecured intercompany loans (I R 15/21). The ruling was required after the German Constitutional Court upheld a complaint against the BFH for overstepping its competence by not passing the case to the European Court of Justice. The BFH now reconfirmed its previous ruling in principle but referred the case back to the lower tier tax court to further consider whether arm's length behavior was given in the specific case.

In the underlying case, a German GmbH had maintained an unsecured clearing account for providing funds to its Belgian subsidiary. In the dispute year 2005, both entities agreed on a waiver directed at the worthless part of the accumulated debt. The German lender wrote down its receivables accordingly and deducted the expense. The tax audit "neutralized" this income reduction on the basis of sec. 1 para. 1 of the German Foreign Tax Act (FTA) because it viewed the fact that the debt was not secured as a violation of the arm's length principle and argued that this feature was conditional for the impairment.

In its new decision, the BFH confirmed previous decisions to the effect that a write-down of an intercompany loan is not deductible under the arm's length principle if the loan default was caused by absent collateralization and such non-collateralization had violated the arm's length principle. The BFH referred the case back to the lower court for adding factual findings on this arm's length requirement. The BFH also comments on what the lower court needs to take into account.

First, the lower tier tax court must determine whether the funds provided via the clearing account can be considered as a loan at all. To assess this, the tax court will have to consider all circumstances leading to the provision of funds, e.g. the borrower's reasonable earnings expectations, influence of the lender on the borrower's business activities, and the shareholder's willingness to support bailing out the borrowing company externally in business transactions. Of particular importance is whether circumstances support the assumption that the provision of funds was only temporary so that both parties had objective reasons to assume a repayment of the funds. This assessment must be made regardless of a potentially unusual waiver of a valuable collateral for the loan.

If the loan character is confirmed for tax purposes, it is to be examined whether a market for unsecured loans can be identified. If such a market and corresponding data exists showing that the intercompany interest rate compensates sufficiently for lack of collateral, a loan impairment cannot be reversed under sec. 1 FTA. If the market exists, but the interest rate did not sufficiently compensate for the lack of collateral, the interest rate needs to be adjusted upward rather than the impairment denied. A reversal of the impairment is only possible if no comparable data exists as this demonstrates that a third party would not have granted the unsecured loan. The tax court has to clarify these issues before the question can be assessed whether the case is to be referred to the European Court of Justice.

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Lower court of Schleswig-Holstein decides on 5% gain inclusion in case of inbound cross-border merger

On 24 March 2022, the tax court of Schleswig-Holstein decided (case 1 K 181/19) that Germany was entitled to tax 5% of any merger gain that arose upon the upstream merger of a French corporation into its German corporate parent, and that this taxation was not a violation of the EU Merger Directive. The court justified this taxation with the need to transfer profit transfers equally, whether they occurred in the form of dividends (where the EU Parent-Subsidiary Directive explicitly allows such 5% taxation) or as merger gain. The case is now pending with the Federal Tax Court under case reference I R 17/22.

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Lower court of Nuremberg specifies when a management holding partnership can be accepted as tax group parent

For a partnership to be accepted as tax group parent in a German income tax group, it is required by law that the partnership carry out an own trade, to which the shares in the tax group (corporate) subsidiary/-ies are functionally allocable. Whether and under which conditions a management holding partnership can be regarded as trading is often a matter of dispute. The Nuremberg tax court (decision of 12 January 2021, 1 K 1090/19) had to decide on a case where there was identity of management between the directors of the partnership parent and the subsidiaries, but there were no service charges made from the partnerships to its controlled subsidiaries. However, the taxpayer could document through written minutes of regular management meetings for the partnership that this entity indeed did not only supervise its subsidiaries, but gave strategic direction and orders to their management. This was in the view of the court sufficient management activity to rise to the level of a trade, and hence enabled accepting the validity of the tax group.

The case has been appealed and is now pending with the highest German tax court (BFH, case reference I R 23/21). While the facts of the particular case are quite peculiar and likely rarely encountered in practice, the question of what constitutes a "trading" management holding is very relevant, also for many inbound structures into Germany which use partnership holdings, and hence the BFH decision should be of interest for a larger number of cases.

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BFH denies dividend treatment for reorganization-related gain transfers within a tax group, allows deferral of income

In a decision dated 21 February 2022 (I R 51/19), the Federal Tax Court (BFH) had to decide whether a German GAAP book gain caused by a merger of a corporation into a German tax group subsidiary, and subject to a transfer obligation under the surviving entity's profit and loss transfer agreement (PLTA) with the tax group parent, was to be treated as a dividend from a tax perspective (thus triggering a taxation on 5% of the amount, and 26.375% creditable or refundable WHT). Alternatively, it could have been treated as a mere difference between the PLTA profit transfer and the taxable income allocated to the tax group parent, which would not have current tax consequences, but only upon a future transfer of the tax group subsidiary. The BFH ruled that dividend treatment was only required where the book/tax profit or loss transfer difference had its cause in facts or events that occurred prior to the tax group's existence, not for such differences caused by reorganizations during the existence of the tax group. An example for a book/tax difference causing a dividend within the tax group could thus be where the tax group subsidiary in year 1 booked a reserve for German GAAP, but not for tax purposes, became a member of a tax group in year 2, and in year 2, the amount for which the reserve in year 1 was booked had to be paid out. In such case, all other things being equal, the book income in year 2 would be higher than the tax result, and the corresponding higher PLTA profit transfer would be treated as dividend in the amount of the difference, as the difference was caused by the pre-tax group book reserve.

While the tax distinction between book/tax transfer differences in a tax group caused prior or during the tax group stays relevant, the tax treatment of such differences caused during the tax group changed in 2021, and may in certain scenarios now also lead to de facto dividend treatment, so that caution must be exercised in reorganizations involving German tax group subsidiaries.

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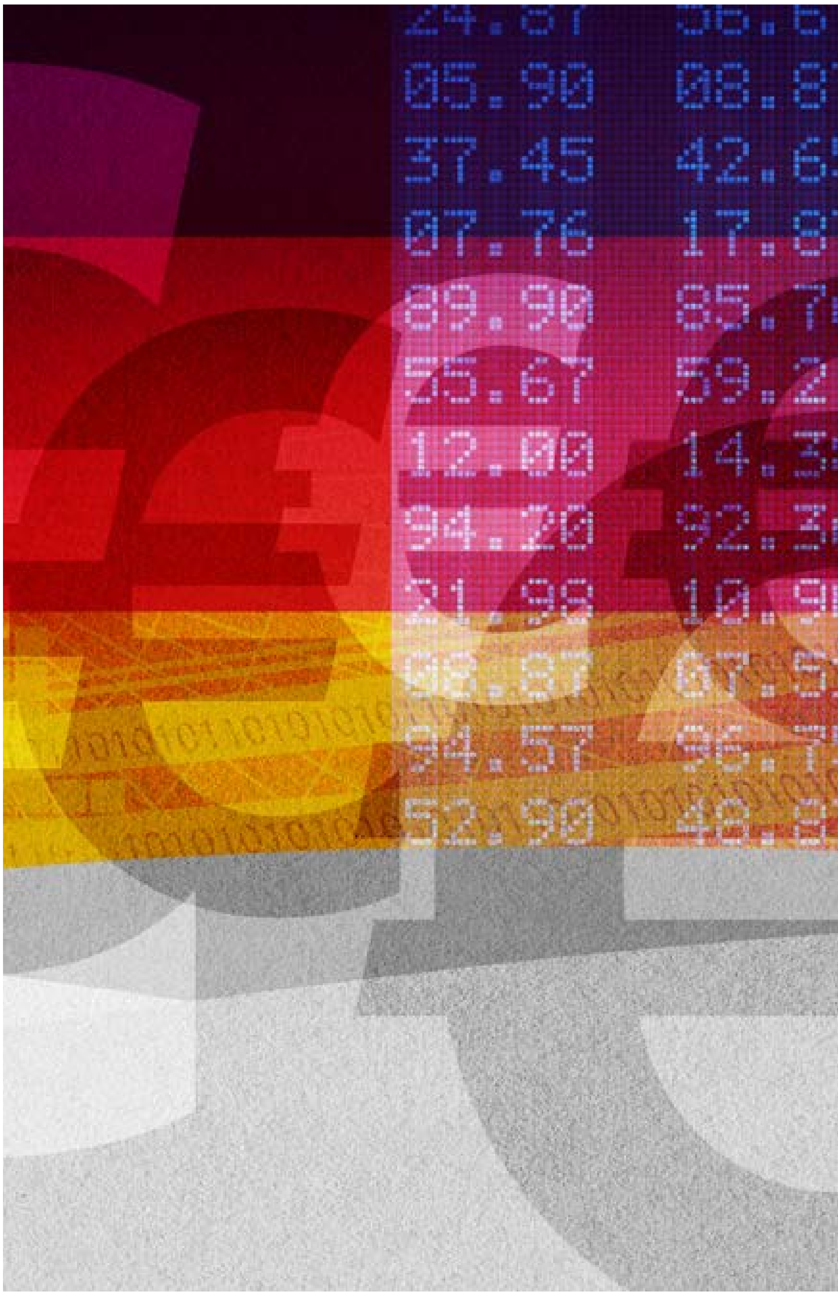
ECJ rules that evidence requirements of German national refund provision on EU withholding tax refund are not in line with the free movement of capital

On 16 June 2022, the European Court of Justice (ECJ) ruled that the German rules for the refund of withholding tax on dividends for non-German corporations under the relevant German domestic provision providing a reduction of withholding tax on portfolio dividends to a 0% rate are not in line with EU law. Under German law, German entities may claim a refund of withholding tax to receive a tax credit in their tax returns, non-German corporations must amongst others provide evidence that withholding tax has not been credited on direct and also on indirect shareholder level. The ECJ found this to be a discriminatory treatment under the free movement of capital (case reference: C-572/20 (ACC Silicones Ltd)).

The German legislator implemented the applicable national provision after the decision of the ECJ in the Commission vs. Germany case (C-284-09) in sec. 32 para. 5 of the German Corporate Income Tax Act. The Cologne tax court had referred the case at hand to the ECJ already on 20 May 2020, questioning whether this domestic provision is in line with EU law (case no. 2 K 283/16). The Cologne tax court is expected to now continue the pending proceeding based on this ECJ decision and render a decision in due course, which the parties of the proceeding may appeal to the German federal tax court.

The development is in line with numerous cases that the ECJ has made on taxation of dividends, only to mention the Fokus Bank case (E1/04) and the following decision of the ECJ in, e.g., Denkavit Internationaal (C-170/05), Amurta (C-379/05), Aberdeen Property Fininvest Alpha Oy (C-303/07), Commission vs. Italy (C-487/07), Commission vs. Spain (C-487/08), Commission vs. Germany (C-284/09) or Fidelity Funds (C-480/16). The German federal tax office currently keeps claims that taxpayers have filed in the past on hold and they have granted refunds in only very limited cases so far. However, long-term investors who could be eligible under the above mentioned decision and do not benefit from a reduction under the relevant double tax treaty or the EU parent subsidiary directive may consider filing a protective claim for refund of withholding tax on dividends that they have received to keep the mandatory timelines. Also, following the decision of the ECJ in Emerging Markets (C-190/12) and College Pension Plan of British Columbia (C-641/17), not only EU countries but also third countries should consider filing protective claims.



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New online formation of the German limited liability company ("GmbH") and other digitalization developments to German corporate law

With effect from 1 August 2022, the Act Implementing the Digitalization Directive (DiRUG) as well as parts of a supplementary act thereto (DiREG; both: Acts), both transforming the Digitalization Directive of the European Union (Directive (EU) 2019/1151 European Parliament / Council of 20 June 2019) into German national law, have come into force. These Acts are especially attractive for foreign founders.

The core topic of the Acts is the newly created possibility to form a German GmbH completely online, i.e. without personal appearance of the founder(s) (respectively their representative(s)) before a notary public in Germany. Now, a founder (resp. representative) can attend the (statutorily required) notarization of the incorporation deed in Germany digitally – from anywhere in the world via a special video communication platform (providing video calls, exchange of messages, electronic signature of the incorporation deed etc.). It is also possible for only one of the founders to attend virtually, whereas another one appears in person in front of the notary. However, this virtually attending founder (resp. representative) must identify her-/himself to the notary with an electronic identification document (eID) recognized in Germany or an eID from another EU/EEA member state with a high security level. So practically speaking, this identification prerequisite is likely to keep many foreign founders from opting for an online formation.

Further, both Acts open the video procedure for certifications of any kind of commercial register applications for all corporations (including for stock corporations (AG) and partnerships limited by shares (KGaA)), partnerships as well as for branches of German and EU/EEA member state corporations.

The remaining parts of the DiREG will come into force on 1 August 2023. These will allow inter alia online GmbH formations by contribution in kind – until then, this is limited to cash formations. They will further allow online notarizations of GmbH shareholders' resolutions regarding amendments to the articles of association including capital increases.

These Acts may be considered as a great step forward in the digitalization of German corporate law. Nevertheless, the legislator is aware that it has not yet taken full advantage of all feasible potential for digitalization. Accordingly, it plans to evaluate the new provisions. In case online notarization (especially the functioning of the video communication platform) prevails, it will consider the extension of online procedures to the formation of AGs, to the notarization of transfer agreements regarding GmbH shares as well as to notarizations pursuant to the German Transformation Act (UmwG). It is therefore worthwhile to continue following the digital developments of German corporate law.

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Current tightening of the Packaging Act – What foreign companies need to know

To achieve the goal of a resource-friendly circular economy, extended producer responsibility (EPR) is becoming increasingly relevant in Germany. EPR is not limited to the actual product. In Europe, as in Germany, the manufacturers of a product are also responsible for the packaging of the product in terms of waste avoidance, reuse, and recycling. In Germany, this is primarily regulated by the Packaging Act (VerpackG). The VerpackG was recently renewed and significantly amended.

The new regulations affect in particular companies that do not have a registered office in Germany, but sell their products in Germany. According to the German Packaging Act, the company that places packaged goods on the market in Germany for the first time on a commercial basis or imports them into Germany (importer) is responsible for the packaging used. The Packaging Act classifies these companies as producers with various obligations. ▸

Spotlight

Since 1 July 2022, all companies that the VerpackG designates as producers are obliged to register centrally. Registration takes place online at the Central Packaging Register Office (ZSVR) and is free of charge. The registration obligation exists regardless of the purpose of the packaging used. Transport, sales, shipping, repackaging and service packaging are all subject to registration. Companies should therefore check as soon as possible – if they have not already done so – whether they are required to register. Serious sanctions (fines of up to EUR 100,000 per case) may be imposed if registration is required but not carried out. Furthermore, companies are not allowed to place unregistered packaging on the market. In many cases, this will effectively mean that the packaged product can no longer be sold.

The German Packaging Act also obliges certain companies to contract with special disposal companies (so-called Systembeteiligungspflicht; system participation obligation). This obligation applies to companies that market packaging filled with goods that typically become waste for private end consumers. Therefore, companies in the b2c business are initially affected by this.

However, it should be noted that large parts of the b2b business are affected by this obligation, too. This is because the Packaging Act includes the so-called comparable points of disposal (hotels, hospitals, cinemas, etc.). These are treated in the same way as private end consumers. Consequently, if packaging typically accumulates as waste in the comparable points of generation, there is an obligation to participate in the system. Companies should therefore immediately check whether they are affected by the system participation obligation. Failure to participate can be sanctioned with a fine of up to EUR 200,000 per case.

The VerpackG newly imposes special obligations on electronic marketplaces and fulfillment service providers. These must ensure that their customers comply with the obligations under the Packaging Act. If verification is not ensured, they are not allowed to provide their services. Violations by fulfillment service providers and operators of electronic marketplaces will also be sanctioned with a fine. Companies that use the relevant services to distribute their packaged products in Germany will have no choice but to provide appropriate verification.

Companies that distribute packaged goods in Germany should check whether they already fulfill all the obligations of the VerpackG. If this is not the case, there is an urgent need for action, especially since several thousand administrative offence proceedings have already been initiated via the ZSVR and organizations such as Greenpeace and Deutsche Umwelthilfe (German Environmental Aid) are increasingly urging compliance with the legal regulations of the VerpackG.

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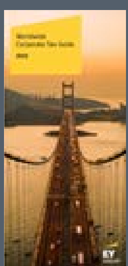
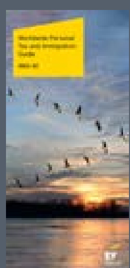


Worldwide corporate tax guide 2022
The worldwide corporate tax guide summarizes the corporate tax systems in 160 jurisdictions.



Worldwide personal tax and immigration guide 2021-22
This guide summarizes personal tax systems and immigration rules in more than 150 jurisdictions.

Worldwide VAT, GST and sales tax guide 2022
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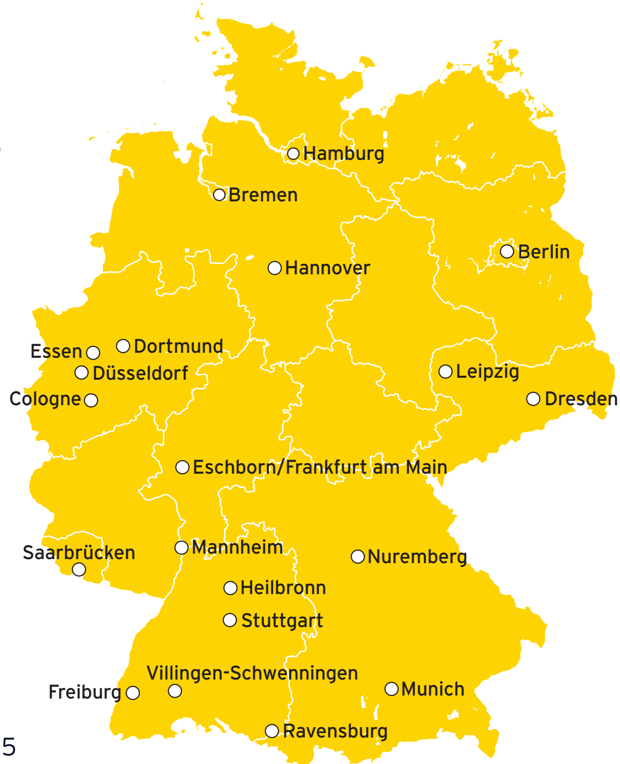

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