http://tax-news.pwc.de/german-tax-and-legal-news

Statutes
Cases
Decrees

Tax & Legal News

Issue 5
20 December 2018

pwc

Official Pronouncements

- Passage of Finance Bill 2018
- Draft Brexit Bill
- FACTA – Automatic exchange of financial information

Tax Court Cases

- Trade tax add-backs not unconstitutional
- Excessive drawings: Ministry of Finance circular amended to reflect Supreme Tax Court judgement

From Europe

- European Court of Justice: EU law compatibility of German trade tax exemption for third country dividends

Official Pronouncements

Passage of Finance Act 2018

On 8 November 2018, the Finance Bill 2018 was adopted by the German parliament and received the consent of the Bundesrat on 23 November 2018 in the form of "The Act for the Avoidance of VAT Losses on the Trading of Goods on the Internet and Amendments to other Tax Regulations"(hereafter "Finance Act 2018"). This article sets out a selection of the new regulations.

Amendments to the Corporation Tax Act

Organschaft: variable compensation payments to external shareholders

As a general rule one of the conditions for the recognition of a corporation tax "Organschaft" (tax group) is that the "Organgesellschaft" (subsidiary company) transfers its whole profit to the "Organträger" (parent company). The draft bill provides that the whole profit will also be treated as having been transferred, even when compensation payments, which exceed the minimum assured amount according to Section 304 (2) 1st Sentence of the Stock Corporation Tax Act, are agreed and paid. However, in such a case the compensation payment cannot exceed the profit share corresponding to the relevant interest in the share capital for the year which would have been paid if no profit transfer agreement had existed. Furthermore, any payments exceeding the amount set out in Section 304 (2) 1st Sentence of the Stock Corporation Tax Act must be based upon an economically reasonable decision.

This amendment is intended to redress the position after the Supreme Tax Court ruled on a number of occasions that the payment to an external shareholder of both a fixed compensation and a variable amount calculated with reference to the annual profit precluded the recognition of an income tax Organschaft, as the whole profit could not then be transferred.

The Bundesrat's proposal regarding public sector entities, multi-utility businesses and municipal corporations was not taken up.

Investment income and Organschaft

The Investment Tax Act 2018 provides for a partial tax exemption for income arising from stock funds, from real estate funds and from mixed funds. The level of the exemption is dependent upon the person of the investor (i.e. whether it is an individual, a corporation or another fund.) Business expenses and losses in business assets, which are economically related to the tax- free income, are not deductible in an amount corresponding to the percentage of the partial exemption.

The nature of the relief has meant that in the case of an income tax Organschaft the transfer of the partially exempt income could give rise to the Organträger receiving either excessive or insufficient relief. (This was due to the fact that an Organträger can be both an individual or a corporation.) To avoid such a systematic discrepancy, the amendment provides that the exempt income should be transferred gross so that the partial exemption relief occurs at the level of the Organträger.

The new provision applies to assessment periods from 2019 onwards.

Loss forfeiture rules: implementation of the decision of the Federal Constitutional Court

On 29 March 2017 the Constitutional Court held as unconstitutional the rule on the partial forfeiture of losses where shareholdings of between 25% and 50% were transferred within a five year period for transactions occurring in the periods 2008 to 2015. The government was required by the Court to introduce new rules retroactively. Rather than introducing a new rule to meet this requirement it was decided to order that the unconstitutional rule should not be applied retroactively at all. The dispensation applies to transfers made after 31 December 2007 and goes beyond the requirement of the Court in that it also applies to periods after 31 December 2015.

This only applies to shareholding transfers of between 25% and 50%. The rule applying to the full forfeiture of losses, where shareholdings of over 50% are transferred, is still applicable. It is worth noting that this rule is also awaiting review by the Constitutional Court (2 BvL 19/17).

Loss forfeiture rules: reintroduction of relief following the decision of the European Court of Justice

In its judgments in, inter alia, Heitkamp BauHolding GmbH) (C-203/16 P), and Lowell Financial Services GmbH (f.k.a. GFKL Financial Services AG) (C-219/16 P) on 28 June 2018, the ECJ held that in its decision to classify the so-called "Restructuring Clause" as illegal State Aid, the European Commission had applied an incorrect reference system and its decision was thus was void. Following the release of the European Commission's decision in 2011, the Restructuring Clause – under which the loss forfeiture rules did not apply in the case of certain restructuring arrangements –had been suspended. The Finance Act 2018 now revokes the suspension and as originally planned, the relief will apply to share transfers made after 31 December 2007.

Tax exemption for restructuring income

Following the issue by the European Commission of a comfort letter stating that no formal notification of Germany's compliance with EU State Aid rules was necessary with regard to the tax exemption on certain restructuring income, the said exemption has been reintroduced from 5 July 2017 retroactively. In addition, upon application, the exemption should apply to debt waivers made on or before 8 February 2017.

Amendments applicable to limited taxpayers

Disposals of shares in real estate companies
The Act introduces a broadening of the Income Tax Act (ITA) provision whereby a non-resident person's capital gain on the disposal of shares will give rise to a limited tax obligation. Under the earlier provision, the gain on disposal of shares was subject to German tax where an interest of at least 1% was held during a five year and the underlying company had its registered office or its place of management in Germany (i.e. was German resident). The rule has now been extended to gains arising from the disposals of shares in a non-resident company, where:

- more than 50% of the underlying value of the share (whether direct or indirect),
- at any point in time in the 365 day period before the disposal,
- is based on immovable assets located in Germany
- and the shares are attributable to the seller at this point in time.

In line with the OECD Model Tax Convention (2014), many of the German tax treaties provide Germany with a taxing right on the capital gain on disposal where more than 50% of the value of a company is made up (directly or indirectly) of immoveable assets located in Germany. To date Germany has been unable to invoke this provision because domestic law did not contain a provision for such a chargeable event.

The new rule should cover situations involving both tax treaty states and states without a tax treaty. The provision applies to disposals made after 31 December 2018 to the extent that the gain relates to changes in value occurring after that date.

Disposals of immoveable assets, rights and aggregates of assets located in Germany and changes in value of related assets.
The new provision includes in the calculation of the chargeable gain on the disposal of immoveable assets, rights and aggregates of assets located in Germany, any changes in value of assets, which have an economic link with the asset disposed of. The provision is a reaction to a decision of the Supreme Tax Court (on 7 December 2016, - I R 76/14) where the limited taxpayer disposed of domestic real estate, from which it had generated letting income. The purchase of the real estate had been financed by a loan provided by a related entity. After the sale, the related entity waived the part of the loan not covered by the proceeds of sale. The Court held that the income arising from the waiver was not taxable in the hands of the limited taxpayer as it neither constituted letting income nor was it part of the capital gain on the disposal of the real estate.

The amendment applies to changes in value occurring after 31 December 2018.

Prevention of tax avoidance: cum/cum transactions

Withholding tax
The ITA provides that in certain listed circumstances, withholding tax on capital yields will not be withheld (so-called suspension of the WHT deduction). The relevant provisions have now been amended to introduce a restriction on the suspension of 2/5ths of the withholding tax available to certain tax privileged corporations where the capital yield emanates from stock held in a collective securities account. The restriction should apply to capital yield receipts in excess of €20,000, where the recipient held the stock as beneficial owner for less than a year at the time of receipt.

The rule is aimed at preventing tax privileged investors being used for cum/cum transactions. The tax withheld will be refunded to the tax privileged investors upon application, provided he meets certain criteria, such as beneficial ownership for a minimum of 45 days and the bearing of a minimum risk.

The rule applies to capital yields received after 31 December 2018.

Prohibition of withholding tax imputation
The provision in the ITA regulating the exclusion of a withholding tax imputation is to be amended for the avoidance of doubt to state that both the refund and the imputation of dividend withholding tax is prohibited, where the dividend is paid to a person who is not the beneficial owner of the shares at the time of the dividend resolution.

Where the claim to a dividend (dividend coupon) is transferred but the voting rights retained, the purchaser of the dividend coup may still obtain a refund of the withholding tax paid; however, the claim in these circumstances will be restricted to 2/5ths of the withholding tax.

The rule applies to capital yields accrued on or after 1 January 2018.

Alterations to the VAT Act

Introduction of filing obligations for operators of an electronic market place
The Act imposes an obligation on operators of electronic market places to provide information on potentially VATable supplies in Germany made by the users of their platform. The information should include the name and address of the supplier, his tax number and/or his VAT ID number, the start-date and the end-date of the tax registration certificate, the place of commencement of the transportation/shipment, the destination, the date and the amount of the supply.

The entrepreneur will have to prove to the operator that he is VAT registered. For these purposes, the local tax office of the entrepreneur should issue a tax registration certificate in paper form. Such a certificate is a condition for the operator obtaining an indemnity against liability for the lost VAT. An online procedure is in the process of being set up.

The new rules come into effect on 1 January 2019.

Enactment of EU Directive on VAT treatment of vouchers
The EU Directive on the VAT treatment of vouchers (Directive (EU) 2016/1065) was designed to ensure a consistency in the tax treatment of transactions involving vouchers within the single market.

The new provision in the VAT Act only applies to vouchers, which can be used for redemption against goods or services. Vouchers entitling the holder to a discount upon purchase of goods or services but carrying no right to receive such goods or services are not subject to the new rules.

As required by the Directive, the provision should take effect from 31 December 2018.

Supply for telecommunications, broadcasting and electronically supplied services
The proposed amendment of the provision relates to suppliers of telecommunications, broadcasting and electronically supplied services, who are only resident in a single Member State. The amendment provides that for entrepreneurs who supply such services to non-entrepreneurs in other Member States, the place of supply will be deemed the place where the entrepreneur runs his business or the place of the branch which provides the supply, provided the total amount of consideration received for the relevant services in both the current and the previous calendar year does not exceed €10,000. The supplier may choose not to apply the supply threshold of € 10,000 and continue to treat the place of supply as the place at which the recipient of the services has his usual residence.

Draft bill - Brexit Ancillary Regulations

On 13 December 2018 the Federal Ministry of Finance published a draft bill for the enactment of tax and other regulations for Brexit ("Brexit Bill") setting out certain tax regulations designed to alleviate certain legal consequences arising by reason of Brexit alone.

Effective date

The Brexit Act is intended to come into force on 29 March 2019 (date of Britain's departure from the EU). This is intended to cover both the scenario of an implementation deal and a No Deal scenario. Where a deal is agreed the regulations will come in to force once the UK is treated as a third country at the end of the transition period on 31 December 2020.

Overview of planned provisions

Where a taxpayer created a balancing item after transferring a fixed asset to a UK branch (i.e. to mitigate the impact of exit taxation), the balancing item would have to be fully released upon Brexit. To avoid this the Brexit Bill provides that balancing items created before Brexit comes into force may continue to be released over the term of the remaining period (5 years maximum). Furthermore, the tax neutral release of the balancing item where the asset is returned to Germany within the 5 year period will continue to apply where the assets were transferred to the UK before Brexit.

The Brexit Bill also envisages an amendment to the Reorganisations Taxes Act. Where a taxpayer has transferred his business to a company or exchanged shares in a company for shares in another company and has applied to treat the transfer as one occurring below fair market value, the lapse of certain conditions within a seven year period will result in the retroactive taxation of the gain. One of the conditions is a condition of EU residency. The draft provision provides that the EU-residency condition will not be deemed to have been breached where the lapse of EU-residency provision is solely a result of Brexit without any action on the part of the taxpayer himself. The provision is intended to apply to transactions where either the transformation/conversion resolution was made before Brexit or where the contribution agreement was concluded before that date.

The Income Tax Act provides for the postponement of the taxation of hidden reserves where specific business assets are sold and other specific assets are acquired which are to be to attributed to a branch of the taxpayer in another Member State; upon application the tax may be paid in 5 equal annual instalments. The Brexit Bill provides for a continuation of this provision provided the application to postpone the tax is made before the UK leaves the EU.

The Corporation Tax Act imposes an exit taxation (by way of a deemed liquidation) upon German resident companies, which leave the German tax net by moving their registered office or place of management to a third country. The Brexit Bill provides that no charge to tax under will arise merely because a company's registered office or place of management becomes located in a third country by reason of Brexit alone.

Likewise, the Foreign Taxes Act imposes an exit taxation on an individual who moves his tax residence outside Germany and who, inter alia, holds a shareholding of 1% or more in a German resident company. The Foreign Taxes Act provides for a postponement of the tax where the individual moves to another Member State or an EEA state. The postponement is revoked, when, inter alia, the individual moves his residence outside the EU/EEA. The draft Brexit Bill provides that the postponement will not be revoked merely because the individual is no longer an EU resident by reason of Brexit alone.

The postponement will however be revoked where there is a withdrawal or other transaction, which does not lead to a release of the hidden reserves per se, but, by reason of which, the shareholding is no longer attributable to a permanent establishment of the taxpayer in the UK or the EU/EEA (e.g. where the shares are transferred from a permanent establishment of the taxpayer in the UK to one in a third country). A change of residence from the UK to a third country will also give rise to a revocation of the postponement, insofar as, following the move, no tax obligation exists in the UK or EU/EEA similar to the German unlimited income tax obligation.

Other provisions intended to alleviate any negative consequences of Brexit include a provision in relation to subsidised pension property (old cases) under Section 93 (1) Income Tax Act and a provision to prevent undue hardship in relation to adjustments to Riester claims. The Brexit Bill also includes regulations in the area of finance intended to alleviate problems in the case of a No Deal.

In addition to the rules referred to above the Brexit Bill provides for a necessary editorial change to the VAT Act as well as transitional rules in relation to the Mortgage Bond Act and Building and Loan Associations Act, which should provide certain grandfathering rights.

FACTA – Automatic exchange of financial information

On 28 September 2018, the Ministry of Finance published a modified version of its circular of 1 February 2017 on the standard for the automatic exchange of financial information in tax matters in relation to the self-reporting of the opening of new financial accounts.

Background

In the fight against cross-border tax evasion and other deficits in fiscal discipline, the OECD developed a standard for the automatic exchange of financial information in tax matters (CRS – Common Reporting Standard). Along with numerous other countries, Germany committed itself to its implementation on 29 October 2014. CRS obliges financial institutes to report to the tax authorities, information about financial assets, which are managed for taxpayers in participating countries. This information is then exchanged between the tax authorities in the participating countries. On 31 May 2013 the FACTA agreement was concluded between Germany and the USA which likewise provides for the automatic exchange of tax-relevant information.

With respect to the FACTA agreement, on 28 September 2018 the tax authorities made certain modifications to its circular of 1 February 2017, which provide for a revision of the circular vis-à-vis the self-reporting of new financial accounts. Furthermore selective adjustments have also been made to the Ministry circular of 1 February 2017, which remains applicable, vis-à-vis the FACTA agreement (Paragraph 230) including a so-called “non-objection clause”.

In this regard, the modification refers to the failure of the financial institute to make a full and/or correct and/or timely declaration, which may give rise to a penalty of up to € 50,000. The modification also provides for a form of dispensation at the end of the 90-day period of grace in circumstances, where the financial institute is unable to obtain the necessary information. Such dispensation kicks in provided no transactions are carried out until a proper report is submitted.

Tax Court Cases

Trade Tax add-backs not unconstitutional

Following earlier case law the Supreme Tax Court has held that the trade tax rules on the add-backs of rent and leasing payments and of the payments for the temporary assignment of rights are not unconstitutional.

The case revolved around the level of add-backs of rent and leasing payments for movable and immovable fixed assets and of payments for the temporary assignment of rights, which all vary under trade tax law. The taxpayer argued, inter alia, that such a divergence violated the principle of consistency which is a pillar of the principle of equality of burden and was thus unconstitutional. The Court disagreed; the fact that the legislature had developed a fiction, whereby rent/leasing payments or payments for the temporary assignment of rights were deemed to contain a financing portion, did not mean that it was obliged to align these financing portions and to set a standard and realistic rate of interest.

Furthermore, since trade tax has the character of a non-personal tax, the principle of taxation according to capacity becomes less relevant. A potential taxation of the underlying substance is also possible in the case of an income-orientated non-personal tax.

Source:

Supreme Tax Court decision of 14 June 2018 (III R 35/15) published on 22 August 2018.

Excessive drawings: Ministry of Finance circular amended to reflect Supreme Tax Court judgement of 14 March 2018 regarding basis for calculating non-deductible interest in the case of excessive drawings.

The restriction on the deduction of interest expense is capped at the cumulative excess of drawings over contributions over the period of the existence of the business since 1998. Rejecting the treatment applied by the German tax authorities, the Supreme Tax Court decided that losses per se could not give rise to excessive drawings. On 2 November 2018, the Ministry of Finance replaced previous circulars written on the subject with a new circular, which recognised the decision of the Supreme Tax Court.

Background:

The Income Tax Act restricts the amount of deductible interest expense where drawings exceed the amount of profits and contributions, giving rise to so-called "excessive drawings". Whilst the interest expense remains deductible in full, an amount is added back to the profits of the taxpayer calculated at the rate of 6% of the excessive drawings (this is capped at the amount of interest expense arising in the relevant year reduced by an amount of €2,050).

Treatment applied by the tax authorities:

The base for calculating the add-back was the sum of excessive drawings[1] over "under"-drawings[2] in the cumulative period starting from financial years beginning after 31 December 1998 to the current year. The form of the calculation meant that cumulative losses were also included in the calculation of the add-back.

The decision of Supreme Tax Court on 14.3.2018, (X R 17/16,):

Rejecting the treatment applied by the tax authorities the Supreme Tax Court set out a two-step approach to calculating the base for the add-back of excessive drawings. The starting point for the calculation should be the profit for income tax purposes; this latter term also includes losses. However, losses of themselves cannot give rise to excessive drawings and thus the base calculation for the add-back should be restricted by way of teleological reduction. Rejecting the relevant part of the Ministry of Finance's circular on the subject dated 17 November 2005, the Court held that when calculating the add-back, the base for the calculation should not exceed the total amount of drawings made in the period from 1999 to the current financial year less the total amount of contributions made during the same period.

This two-step approach has now been adopted by the tax authorities in the Ministry of Finance's revised circular dated 2 November 2018.

[1] i.e. where the drawings exceed the sum of profits and contributions

[2] i.e. where the drawings are less than the sum of profits and contributions

From Europe

European Court of Justice: EU law compatibility of German trade tax exemption for third country dividends

On 20 September 2018, the European Court of Justice (ECJ) issued its judgement in EV (C-685/16). The underlying question of the case was whether the "activity clause" in the German Trade Tax Act applicable to dividends sourced in third countries contravenes the EU principle of free movement of capital (Art. 63 of the Treaty on the Functioning of the EU - TFEU).

Background

The plaintiff, a company resident in Germany, held 100% of the shares in an Australian corporation. The Australian corporation distributed dividends to Germany, of which 95% were exempt for German corporation tax purposes. However, for trade tax purposes, the exemption was subject to certain conditions. One of the conditions for obtaining the trade tax exemption was that the distributing subsidiary generates "active income" within the meaning of the German Foreign Tax Act. In the case at hand, the tax authorities took the position that the distribution had been funded from passive income sources so that no trade tax exemption for the dividends received was granted. In contrast, no such "activity test" is applied to dividends received from domestic corporations. Due to this difference in treatment, the plaintiff argued that the rule was contrary to the free movement of capital.

Judgement

The ECJ ruled that the difference in treatment of domestic and foreign dividends from third countries constituted a restriction of the free movement of capital.

The ECJ also examined in more detail to what extent this infringement of the free movement of capital was grandfathered under the so-called "standstill clause" (Art. 64 TFEU). Since the legislation under review had been in place before 31 December 1993, the ECJ had to decide whether the standstill clause was still applicable bearing in mind that certain legislative changes to the provision had been made in the meantime.

Referring to earlier case law the Court noted that a provision will be covered by the derogation, where it is, in essence, identical to the previous legislation, or any changes are limited to reducing or eliminating an obstacle to the exercise of rights and freedoms established by EU law. By contrast, legislation which is based on an approach, which differs from that of the previous law and which establishes new procedures cannot be treated as legislation existing at the date fixed in the EU measure in question.

In the case before the Court, not only had the provision on trade tax exemption for dividends from third countries itself been subject to changes (i.e. the threshold was increased from 10% to 15%), but the German dividend taxation system had also been revised leading to a change from an imputation system to a shareholder relief system. Due to these changes, the ECJ held that the derogation could not apply. Finally, the ECJ ruled that there was no justification for the restriction. One of the German Government's arguments was that the legislation had been put in place to counter abusive tax planning. However, the ECJ rejected this argument: the trade tax provision under review made a general presumption of abuse in any case where dividends were not paid out of active income (i.e. the taxpayer was not given the chance to rebut the presumption).

Significance

The judgment in the EV case has significant practical impact on the tax treatment of third country sourced dividends for German trade tax purposes. It sets up the principle that an "activity clause" with no "motive test" is not in line with the fundamental freedoms of the TFEU if the provisions regulating the tax exemption for domestic dividends also do not include such a clause. Furthermore, the judgment reconfirms that the fundamental freedoms are highly relevant in respect of tax provisions of EU Member States that infringe the free movement of capital in relation to third countries.

Source:

European Court of Justice: EV C-685/16, published on 20 September 2018.

From PwC

Guide to Doing Business and Investing in Germany

The 2017 edition of our popular Guide to Doing Business and Investing in Germany is now off the press and freely available to those interested. It can be downloaded from
http://www.pwc.de/en/internationale-maerkte/doing-business-and-investing-in-germany.html

If you would like a printed copy, please contact Svenja Niederhöfer at svenja.niederhoefer@de.pwc.com

Breaking news

If you would like to follow the latest news on German tax as it breaks, please visit our Tax& Legal News site at
http://tax-news.pwc.de/german-tax-and-legal-news

English language blogs in which you may be interested are
CITT (Customer and Investor Tax Transparency) News http://blogs.pwc.de/citt/
Establishment of Banks http://blogs.pwc.de/establishment-of-banks/

Editor's Office

Emma Moesle
PricewaterhouseCoopers GmbH
WPG Friedrich-List-Straße 20
45128 Essen
Tel.: +49 201 438-1975
emma.moesle@de.pwc.com

Subscribe

You may take out a new subscription to the newsletter with a simple e-mail to SUBSCRIBE_PwC_Mandanteninformation_E@de.pwc.com. Existing subscriptions may be cancelled at UNSUBSCRIBE_PwC_Mandanteninformation_E@de.pwc.com.