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Ministry of Finance publishes draft bill on the implementation of the global minimum taxation (so-called Pillar 2)

On Monday, 10 July 2023, the Federal Ministry of Finance sent the draft bill for the implementation of the Directive to ensure a global minimum level of taxation for multinational enterprise groups and large domestic groups in the Union (so-called Minimum Taxation Directive Implementation Act – "Implementation Bill") to the associations with the request for comment by 21 July 2023.

After the adoption of the Directive on the implementation of a global minimum taxation by the Council of the EU on 15 December 2022, a discussion draft on the implementation of the Directive into national law was published by the Federal Ministry of Finance (MoF) on 20 March 2023 (see **Newsflash** of 21 March 2023). The MoF issued its initial discussion draft and received extensive submissions from the associations before the OECD had published its so-called Administrative Guidance; the draft bill (dated 7 July 2023) sent to the associations on 10 July now takes the OECD Administrative Guidance into consideration.

The draft bill for the Minimum Tax Implementation Act now comprises 95 paragraphs (instead of 89 paragraphs in the discussion draft). In addition, there are accompanying changes in the General Tax Code and the Fiscal Administration Act.

Furthermore, some significant amendments are proposed to the Income Tax Act ("ITA") and the Foreign Taxes Act with the abolition of the royalty limitation rule, the lowering of the low tax definition threshold and the abolition of the trade tax liability on deemed CFC income.

Significant changes in the draft bill compared to the discussion draft

i) Equalisation claims within a minimum tax group

The first change is related to the **minimum tax group in Section 3 draft Minimum Tax Act**. Since the provision leads, inter alia, to minimum tax liabilities under the Minimum Tax Act being concentrated at the level of the German group parent and thus to other German group companies being exempted from their minimum tax liability, Section 6 now creates a statutory basis for the business entity paying the **minimum tax liability to claim compensation from the German group companies** whose supplementary tax amounts were attributed to it. Conversely, tax refunds must be passed on accordingly by the group parent to the other German business entities. The equalisation claims do not increase or decrease the income according to ITA or CTA.

ii) Starting point for determining the GloBE income or loss

Through Section 15 (1) Sentence 1, draft Minimum Tax Act, the term "minimum tax net income or loss" was introduced (previously referred to as "financial accounting net income II or financial accounting net loss II"- " *Jahresüberschuss II oder Jahresfehlbetrag II*").

The minimum tax annual income or loss is the annual profit or loss derived for consolidation purposes from the financial accounting of the respective business entity and adjusted to conform with group recognition and valuation rules and before consolidation adjustments and the elimination of intra-group transactions. The definition originates from the previous definition of "the commercial balance sheet II" (Section 7 (10) Minimum Tax Act as amended by the discussion draft), which is no longer included for this purpose.

iii) Tax liability of portfolio dividends (Section 35 draft Minimum Tax Act)

Upon application and by way of derogation from Section 19 (1) No. 2 draft Minimum Tax Act portfolio dividends from long-term participations (participation amount < 10%, participation duration > 12 months) shall not be deducted when calculating the minimum tax profit or loss. The option may be exercised per business entity. If the option is exercised, it applies for five years and uniformly for all participations of a business entity.

iv) Tax liability for excluded equity gains or losses (Section 36 draft Minimum Tax Act).

Upon application, certain equity gains and losses are not to be excluded in the calculation of the minimum tax income or loss, in derogation of Section 20 draft Minimum Tax Act.

The option may only be exercised for gains and losses from shareholdings in a corporation with a participation of at least 10% (hereinafter “participating shareholdings”) which

1. would be excluded if the option under section 20 draft Minimum Tax Act was exercised;
2. are taxable and not exempt from taxation.

Gains or losses from the change in fair value are also to be included where only the disposal of the participation is subject to taxation and only deferred taxes are to be recognised in respect of the change in fair value.

The option is valid for five years and is to be exercised uniformly for all (!) business entities of a tax jurisdiction holding such participating shareholdings.

Revocation of the option is not possible for equity investments for which a loss has been recognised due to the exercise of the option.

v) Currency risk hedging in the case of participating shareholdings (Section 37 draft Minimum Tax Act)

Certain so-called qualified currency gains or losses of a business entity can be excluded from the calculation of the minimum tax gain or loss pursuant to section 37 (1) draft Minimum Tax Act upon application by the business entity subject to the reporting obligation.

Qualifying gains or losses are those which

1. serve to hedge currency risks in participating shareholdings within the meaning of Section 19 (1), No. 1 draft Minimum Tax Act, which are held by the business entity itself or another business entity,
2. are recognised in the consolidated financial statements in so-called other comprehensive income (OCI), and
3. relate to a hedging instrument which qualifies as an effective net investment in a business under an approved accounting standard applied in the preparation of the consolidated financial statements.

The option is valid for five years and is to be exercised uniformly per business entity.

vi) Qualified restructuring gains (Section 38 Draft Minimum Tax Act)

Certain qualified restructuring gains are to be excluded from the calculation of the minimum tax profit or loss pursuant to section 38 (1) draft Minimum Tax Act upon application by the reporting business entity.

A restructuring gain is the income from a debt waiver where one of the circumstances set out in Section 38 (2) draft Minimum Tax Act applies:

1. at the time of the waiver, insolvency proceedings have been opened in relation to the assets of the business entity and such proceedings are subject to the control of a court or other independent judicial body, or an insolvency administrator has been appointed who is independent of the debtor (Section 38 (2) No. 1);
2. considering liabilities of third-party creditors alone, the business entity will become insolvent within twelve months, unless these liabilities are discharged, and there is a substantiated forecast of this by an independent expert (Section 38 (2) No. 2); or
3. neither 1 nor 2 apply but, immediately before the date of the debt waiver, the liabilities of the business entity exceed the fair value of its assets (over-indebted amount (Section 38 (2) No. 3)).

"Qualifying" gains within the meaning of Section 38(3) arise:

1. always where Section 38 (2) No. 1 above applies.
2. in Section 38 (2) No. 2 situations, where the restructuring gain relates to third-party creditors as well as gains related to creditors affiliated within the meaning of Article 5, Subsection 8 OECD-Model Tax Convention, provided also that restructuring amounts can be regarded as part of a uniform restructuring effort with third party creditors.
3. in Section 38 (2) No. 3 situations, all restructuring gains in connection with third-party creditors, but not exceeding the smaller of the following two amounts:
    a. the amount of over-indebtedness; or
    b. the aggregate amount of any national tax attributes lost as a result of the restructuring under the tax laws of the State in which the business entity is located.

(vii) Transition year tax attributes

Various amendments have been made to Section 78(3) draft Minimum Tax Act (previously Section 73(3) draft Minimum Tax Act - *transfers of assets between business entities*). Firstly, an amendment has been made so that all transfers considered comparable to a transfer of assets are also covered by this rule. This is particularly the case if the book value of an asset increases as a result of the transaction.

Secondly, clarification has been given that the deferred tax assets and liabilities of the transition year are to be determined without the inclusion of deferred tax assets and liabilities which emanate from transfers of assets between business entities during the transition period.

If, on the other hand, the transferring business entity has paid covered taxes on a disposal gain, then, by way of derogation, upon application of the reporting business entity, either:

- a deferred tax asset may be recognised based on the covered taxes paid by the transferor business entity on the disposal gain; or
- the acquiring business entity retains its book value amount for the asset.

The exemption is limited to the amount of the gain multiplied by the minimum tax rate of 15%.

viii) Transitional provisions for mixed CFC taxation regimes

Section 84 draft Minimum Tax Act regulates the allocation of covered taxes between business entities in the case of so-called mixed CFC taxation regimes. In contrast to Section 41 (1) No. 3 and (2) draft Minimum Tax Act, the tax to be allocated to the individual business entities is to be determined according to a specific formula.

A mixed CFC taxation regime is a form of CFC taxation where:

- profits, losses as well as creditable taxes of all (!) foreign entities are considered in aggregate for the purposes of calculating the deemed CFC income of the directly or indirectly participating shareholder of these foreign entities; and
- the deemed CFC income so aggregated is subject to an applicable tax rate below 15%.

By way of example, the US GILTI regime, in particular, is considered a mixed CFC tax regime.

The transitional arrangements are limited to financial years beginning before 31 December 2025 and ending on or before 30 June 2027.

ix) Taxation period

According to Section 89 Sentence 2 draft Minimum Tax Act, the taxation period for minimum tax is the calendar year.

ix) Rules on penalties

Pursuant to Section 92 of the draft Minimum Tax Act, failure to submit the GloBE Information Return, or submitting it late or not in the prescribed manner, as well as its incorrect or incomplete submission, is an administrative offence and may be punished by a fine of EUR 30,000.

However, the fine will be waived during the transitional period (financial years beginning on or before 31 December 2026 but ending before 1 July 2028) if the reporting entity demonstrates that it has taken all reasonable steps and can justify not filing on time or in the prescribed manner or not filing correctly or incompletely.

Various

Section 43 (3) and (4) draft Minimum Tax Act now contain provisions for the carry forward of a so-called top-up tax amount arising in certain constellations.

Amendments have been made to Section 47 (1) No. 5 draft Minimum Tax Act with regard to deferred taxes in connection with the creation and use of tax credits.

So-called RT1 instruments of insurance companies have been included in Section 28 draft Minimum Tax Act.

Section 30 draft Minimum Tax Act now contains regulations on unit-linked insurances in the case of insurance entities.

In Section 70 draft Minimum Tax Act, changes were made to the "tax transparency option" for investment entities.

Changes in other tax laws in connection with the Minimum Tax Act

i) General Tax Code

Section 152(3) and (4) of the General Tax Code have been amended to also include tax returns filed under Section 90 of the draft Minimum Tax Act , so that a late filing surcharges need not be compulsorily imposed in the event of late filing.

ii) Fiscal Administration Act

Section 5(1) No. 5h of the Fiscal Administration Act provides that the Federal Central Tax Office

1. shall receive the GloBE Information Return pursuant to Section 72 of the Minimum Tax Act and shall forward it to the respective competent Federal State revenue authority
2. shall receive the reports on the ultimate (domestic) parent in accordance with section 3(4) draft Minimum Tax Act, and
3. shall administer penalty procedures in accordance with Section 92 draft Minimum Tax Act.

Other changes

The draft bill provides for a repeal of the so-called royalty limitation rule regulated in Section 4j ITA with effect for expenses incurred after 31 December 2023. In view of the expiry of the transitional period on 30 June 2021 for the adjustment of non-nexus-conforming preferential regulations to BEPS Action Point 5, a large number of measures against profit shifting that have been agreed internationally in the meantime as well as the special international position of Section 4j ITA, the abolition of the provision is considered justified.

In addition, the low tax threshold in Section 8 (5) Foreign Taxes Act is to be lowered from 25% to 15% with effect from the 2024 tax year. The trade tax liability applied to deemed CFC income and to certain foreign permanent establishments (Section 7 Sentences 7 to 9 Trade Tax Act) is to be abolished for periods after the 2023 assessment period.

Schlagwörter

EU-Directive, GloBE Rules, Pillar Two, minimum taxation