Building a better working world

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Growth Opportunities Act halted by Federal Council and referred to Reconciliation Committee

Several proposed tax cuts expected to be removed before bill is passed by parliament

Content

The German Federal Council (Bundesrat, upper house of parliament) preliminarily stopped the Growth Opportunities Act and initiated a reconciliation committee procedure with the aim to fundamentally revise the act. Prior to the decision, several state officials criticized the bill for causing excessive tax revenue losses particularly for state governments and municipalities. The act adopted by the Bundestag (lower house of parliament) on 17 November 2023 was planned to provide for an annual tax relief of EUR 6.3 billion in 2024, with a significantly higher tax relief in the years 2025 to 2027. During the parliamentary proceedings, members of parliament belonging to the government coalition parties had already reduced the tax cuts to anticipate known state demands. ▸

Growth Opportunities Act halted by Federal Council and referred to Reconciliation Committee

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Nevertheless, the Growth Opportunities Act with its important tax incentives would still be a much needed economic stimulus to counter the current recession in Germany. Major measures are, e.g.:

- Introduction of a tax credit for climate protection investments, available for investments as from 1 March 2024 to the end of 2029. The premium is to be available for investments in new and existing depreciable movable fixed assets that are part of an energy-saving or energy-management system. The premium would amount to up to 15% of the investment, but would be capped at EUR 30 million per taxpayer for the total six-year period.

- The existing R&D allowance of 25% of the qualifying R&D payroll expenses is to be tripled to up to EUR 3 million benefit per year and extended to also cover the acquisition and production costs of depreciable movable fixed assets used in a qualifying R&D project. In addition, the conditions for contract R&D and SMEs are improved.

- The tax loss carryback for individual income tax or corporate income tax (CIT) purposes at the increased amounts of EUR 10 million for an individual and EUR 20 million in case of joint assessment of individuals is extended until 2025. As from 2026 it will be reduced to EUR 5 million / EUR 10 million).

- For tax years 2024 through 2027, a tax loss carryforward that exceeds EUR 1 million can be offset against positive income with 75% of the exceeding amount. The changes would also apply for trade tax purposes.

- Accelerated depreciation for movable assets purchased or manufactured after 30 September 2023 and before 1 January 2025 is temporarily reintroduced. Accelerated depreciations are also implemented or expanded for buildings used for residential purposes as well as for low-value assets.

On the other hand, the bill contains measures to offset the tax cuts.

- The interest deduction limitation is reformed and adjusted to the requirements of the EU Anti-Tax Avoidance Directive (ATAD). However, the initially planned anti-fragmentation rule, which would have restricted the use of the EUR 3 million interest allowance, was deleted from the bill.

- New transfer pricing rules are introduced for cross-border financial relationships with related parties. The new rules replace a rule that was planned to entirely deny the deduction of interest expenses paid to related parties (cross-border and domestic) to the extent they exceed a variable maximum rate.

- Mandatory disclosure rules for domestic tax arrangements are introduced.

At the time of writing this article, it is expected that the reconciliation committee will agree on deleting some of the tax cuts from the bill. Especially the provisions for an enhanced use of loss carryforwards and for improved depreciations seem to be at the top of the list of potential cuts. The revised bill could pass both parliamentary chambers in the course of December 2023. An agreement could, however, also be postponed to early 2024 if the negotiations in the reconciliation committee prove difficult.

We will provide an update in the next issue of the German Tax & Legal Quarterly.

Contact: roland.nonnenmacher@de.ey.com

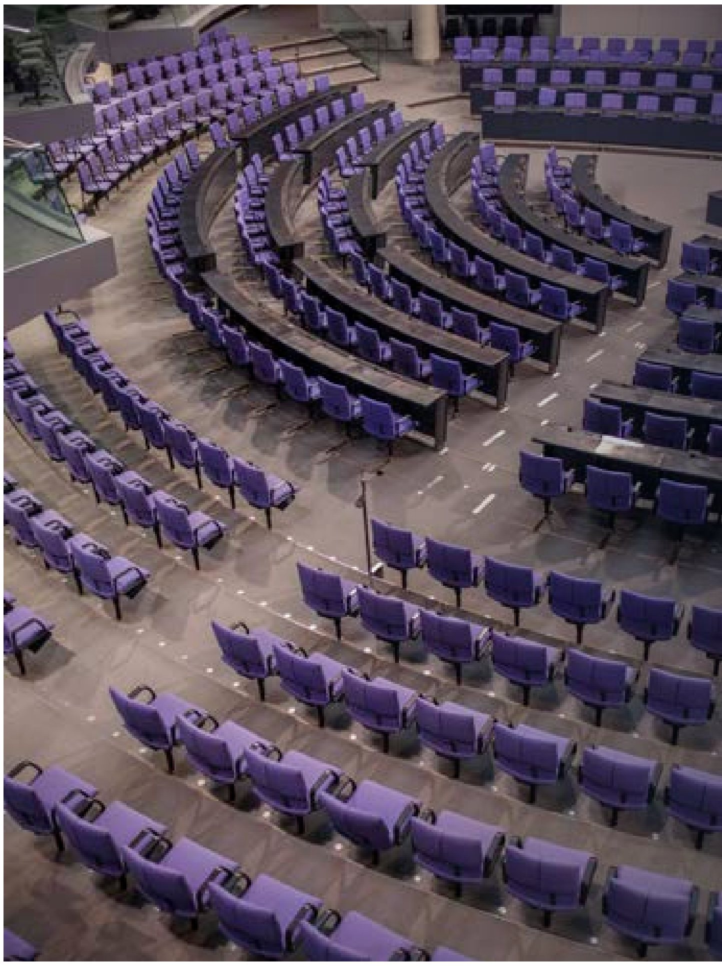
Germany officially implements Pillar 2

While some EU Member States are struggling to meet the implementation deadline of the EU minimum taxation directive (31 December 2023), Germany is on the forefront of the Pillar 2 introduction. Technically, the formal legislative procedure is not fully completed yet, but it is foreseeable now that Germany will implement Pillar 2 by the end of 2023. On 10 November 2023, the Bundestag (lower house of parliament) adopted the final bill. The approval by the Bundesrat (upper house of parliament) is planned to take place on 15 December 2023 and is expected to be a mere formality.

The German bill implements Pillar 2 in line with the EU directive and including latest amendments of the OECD administrative guidance. The Minimum Tax Directive Implementation Bill includes a primary "Income Inclusion Rule" (IIR) (applicable from 2024), a secondary "Undertaxed Profit Rule" (UTPR) (generally applicable from 2025), and a "Qualified Domestic Minimum Top-up Tax" (QDMTT). Given the German corporate tax level of (on average) more than 30%, the German QDMTT is not expected to contribute much to German tax revenue. According to the bill, the German Government estimates that the minimum tax will raise, in total, not more than EUR 200 million per year, with a peak of up to EUR 1 billion in 2026.

Besides several minor adjustments in comparison to the Government draft bill from 16 August 2023, the final version contains some important amendments, most of them in relation to the OECD Agreed Administrative Guidance of 17 July 2023 that were not included in the draft bill, e.g.:

- Amended Safe Harbor provisions, in particular inclusion of new sections on the Simplified Calculations Safe Harbor Framework, the QDMTT Safe Harbor and the Transitional UTPR Safe Harbor.
- Additional rules on Marketable Transferable Tax Credits and on Qualified Flow-Through tax benefits.
- Regarding the Substance-Based Income Exclusion rule, implementation of the 50% threshold for employees working in other jurisdictions and tangible assets used in other jurisdictions as well as new provisions for operating leases.
- General currency conversion rules if the group's consolidated financial statement is not calculated using the Euro.
- New provisions that authorize the Federal Ministry of Finance to release domestic regulations to implement upcoming internationally agreed rules on information exchange on the GloBE information return and other amendments by the OECD.



Furthermore, the bill reduces the low-tax threshold for German controlled foreign company (CFC) tax purposes as well as for the royalty deduction limitation rule from 25% to 15% as of 2024.

With the upcoming publication of the finalized Pillar 2 act, German lawmakers are bringing an extensive legislative procedure including three public consultations to an end. But Pillar 2 implementation will continue in 2024. As noted above, new regulations will provide further details, e.g., on the GloBE information return. In addition, representatives of the Federal Ministry of Finance have repeatedly indicated that they expect amendments and corrections to the implementation act to become necessary based on the first experiences with the act. Furthermore, new agreed OECD administrative guidance could trigger additional requirements for adjustments, and several details are expected to be clarified in an extensive domestic Pillar 2 administrative guidance circular in 2024.

Contact: dirk.nolte@de.ey.com | moritz.glahe@de.ey.com

Tax reform for employee shareholdings

Employee participation is a crucial incentive and retention element to attract urgently needed talent, especially for startup companies. The "Future Financing Act" (Zukunftsfinanzierungsgesetz) has been designed to strengthen the culture of participation and competitiveness within the startup scene by changing the taxation of employee shares.

The tax-free allowance for employees will increase from EUR 1,440 to EUR 2,000 for shares handed to the employee at a reduced price or for free. In contrast to the original plans, the law does not require the participation to be paid in addition to the salary. It is therefore still possible to use the tax-free allowance for the preferential acquisition of shares through salary conversion. Also, the law does not require a holding period to benefit from the tax-free allowance. As before, the tax-free allowance only applies if participation is generally open to all employees.

The possibility of deferred taxation is also expanded. Although this rule already exists, it is rarely used because few companies meet the current requirements. According to the new regulation, employees at older and already established startups can also benefit. Deferred taxation increases the attractiveness of shareholdings, as normally the benefit from a discounted share acquisition must be taxed immediately. Employees would therefore have to pay taxes on a participation that has not yet brought them any cashflow ("dry income"). Currently, this situation also occurs in the event of a change of employer, which triggers taxation. So far, this has severely impaired the use of real shares as an employee participation instrument.

In the future, employers can guarantee that they will pay the deferred income tax upon the sale of shares. A change of employer will then no longer trigger taxation. This is intended to secure tax revenue even in cases where employees have already left the company when the shares are sold. Incidentally, this regulation also applies to shares with transfer restrictions ("Vinkulierung"). Unfortunately, however, only shares in the direct employer may benefit, group setups are not covered.

Another notable change envisaged by the Future Financing Act is that applications, notifications and reports can also be submitted to the German Federal Financial Supervisory Authority (BaFin) in English in future. This is intended to make the German financial market more internationally accessible.

Overall, the reform is a step forward for startups and their employees, as it allows taxation of future upside as capital gains if real shares are transferred at the beginning. Since the Federal Council (Bundesrat, upper house of parliament) agreed in November, the regulations will take effect from 2024.

Contact: martin.neutzner@de.ey.com | caroline.schueler-holst@de.ey.com

Taxation of cross-border commuters working from home – new protocols to tax treaties with Austria and Switzerland

On 21 August 2023, Germany signed protocols to the double tax treaties (DTTs) with Austria and Switzerland during a joint meeting of the finance ministers of the German-speaking countries Germany, Austria, Switzerland, Luxembourg, and Liechtenstein. The new cross-border commuter regulations now take into account the trend of working from home and symbolize a major change in Germany's treaty practice.

As the working environment keeps developing further, especially working from home is becoming more and more established. Against the background of the new social security framework agreement regarding telework from another state within the EU/EEA/Switzerland (effective as of 1 July 2023), also the legislative tax authorities now aim to simplify the current regulations. As a starting point, the specific cross-border commuter regulations in the treaties between Germany and Austria as well as between Germany and Switzerland have been eased.

Cross-border commuter regulations – an overview
The cross-border commuter agreements in the DTTs allow employees who live in one country and work in another to pay taxes in their country of residence instead of their country of work. To qualify for the agreement, the employee must commute across the border on a regular basis.

New protocol to DTT between Germany and Austria
Until now, the DTT between Germany and Austria has attributed the right to tax employment income derived from a non-self-employed activity to the state of residence:

- if the employee concerned has their residence "close to the border" in one state and their place of work "close the border" in the other state (within a distance of not more than 30 kilometers from residence to the border)

- and returns from their place of work to their residence every day (up to 45 days a year of non-commuting are not harmful).

Currently, the distance between the residence itself (not the municipality) and the border is decisive.

According to the amendment protocol, however, it is sufficient if the employee concerned has their main residence close to the border and usually exercises their non-self-employed activity near the border, so that the right to tax income derived from this employment activity belongs to the state of residence.

In the future, a municipality will be considered to be close to the border if its territory is located entirely or partially in a zone of 30 kilometers on both sides of the border.

It is no longer necessary for the employee to cross the border every day (or at all). Home office days are now irrelevant for calculating the non-commuting days with respect to the specific cross-border commuter regulations.

New protocol to DTT between Germany and Switzerland
Until now, an employee qualifies as a cross-border commuter within the meaning of the DTT between Germany and Switzerland:

- if the employee concerned has their residence in one state and their place of work in the other state

- and returns from their place of work to their residence regularly (up to 60 days a year of non-commuting are not harmful).

In contrast to the cross-border commuter regulations between Austria and Germany, a specific distance requirement between residence/workplace and border was eliminated from the DTT between Germany and Switzerland several years ago. ▸

Legislation

The status as a cross-border worker is lost if an employee does not return to their residence for more than 60 days in a calendar year due to their working activities/ requirements. The days to be considered as workdays under the DTT Germany-Switzerland are defined by the amended protocol according to the days agreed upon in the employment contract. If there is no such agreement, the actual workdays are used. The Ordinance on the Implementation of Consultation Agreements between the Federal Republic of Germany and the Swiss Confederation (KonsVerCHEV), on the other hand, is based on the obligation to be present at the workplace.

Absences due to vacation and illness (according to the KonsVerCHEV: illness and accidents) are not considered as workdays in that respect.

The term "regular return" was not explicitly included in the KonsVerCHEV. However, Sec. 7 regulates for minor employment relationships that a regular return is also given if an employee commutes between their residence and their place of work at least one day per week or at least five days per month due to their employment contract.

The amendment protocol now determines that a regular return exists in general if an employee commutes between their residence and their place of work and returns on at least 20% of the contracted workdays (based on the specific definition in the individual employment contract) in the calendar year.

Conclusion
The new regulations can be seen as a first step on the way to a new German treaty practice and future simplification of cross-border remote working activities. Especially in the new Austrian protocol, the general qualification of activities performed in the employee's home office (main residence) as not harmful is a huge accomplishment. On the other hand, the above specified regulations only apply for employees who fulfill the criteria as "cross-border commuters". For all other employees (not residing close to the border or not commuting frequently) the modifications are not relevant. Further it is worth mentioning that neither the cross-border regulations for tax purposes are in line with the new social security framework and the "teleworker" definition nor do the new protocols provide any simplification for corporate tax compliance (creation of permanent establishments with respect to home office activities or remote working).

Overall, further steps – at least within the European Union – covering not only neighboring countries and also considering social security and corporate tax topics would be desirable to contribute to and enhance the new, post-Covid, working environment.

Contact: heidi.schindler@de.ey.com

Collective actions in Germany – New law on representative actions in force since 13 October 2023

As already reported in our article in ***German Tax & Legal Quarterly issue 2|23***, the EU issued a directive on representative actions for the protection of consumers in 2020 which the member states were to implement by December 2022. Since entering into force on 13 October 2023, the new system of collective legal protection for consumers and small businesses poses an additional risk for companies.

Through the new law, Germany has gained a new form of consumer protection: the redress action. With the entry into force of the so-called Verbraucherrechtedurchsetzungsgesetz (VDUG) on 13 October 2023, consumer associations can bring redress actions that go beyond the previous possibility of a model declaratory action and relate to claims for damages, repairs, compensation, price reductions, contract terminations and refunds. Federal Minister of Justice Marco Buschmann cites "flight delays, unlawful account fees, defective product series" as specific examples. With the new redress action, consumers could obtain their rights more quickly. If they are successful, they would receive the money they are entitled to directly and would not have to go to court again. This means that companies face increased risks in the event of breaches of consumer protection laws. ▸

Legislation

The final version of the VDUG diverges from the draft bill described in our last article in several points:

- Small companies are considered consumers if they have less than 10 employees and the annual turnover or the annual balance sheet does not exceed EUR 2 million.
- Qualified entities are not required to have a minimum number of members, the only prerequisite is the entry in a litigation register and a maximum of 5% of their funds coming from companies.
- The deadline for joining the representative action was postponed to six weeks after the last court hearing; no settlement or judgement is allowed before that deadline.
- The requirements for the similarity of the claims have been reduced.
- The qualified entities have to disclose the source of their fundings and potential funding agreements with third parties.

Still, only consumers that join the representative action benefit from the suspension of the limitation period of their claims. In line with the directive, the suspension through redress and injunction actions only applies to claims that arose after 12 October 2023. To suspend the limitation period for earlier claims, qualified entities will have to file a declaratory model action (Musterfeststellungsklage) in addition to a redress or injunction action.

The Federation of German Consumer Organisations (Verbraucherzentrale Bundesverband) has already filed the first representative actions, inter alia against a telecommunications provider and various energy supply companies. Several national and international class actions are very likely to follow.

Contact: michael.kawalla@de.ey.com

German law makers aim to lower energy prices for the economy without overstepping constitutional boundaries

Some of the most prominent legislative activities of the current German government are at stake due to a ruling of the German Constitutional Court. The Court recently ruled that the relocation of unused debt to the so-called Climate and Transition Fund (CTF) was unconstitutional. This has resulted in a situation in which the government has to rethink most of the legislative actions it has taken or was about to take.

Among the legislative actions affected by this decision is the planned extension of the energy price limits, which the Bundestag (lower house of parliament) had approved just before the verdict and which was recently “revoked” by Federal Chancellor Olaf Scholz (SPD). Although the Court’s verdict does not directly apply to the energy price limits as they are not to be paid out of the CTF, but out of the so-called Economic Stabilization Fund (ESF), the administration considered both funds to be comparable and thus unconstitutional.

Apart from the price limits, the Chancellor, Federal Minister of Economics Robert Habeck (Greens) and Federal Minister of Finance Christian Lindner (FDP) had agreed on a so-called electricity price package. Currently, it is not certain whether and how the package is affected by the Constitutional Court’s decision. The package essentially comprises of two parts. In addition to reducing the electricity tax for companies in the manufacturing sector to the European minimum of 0.05 cents per kilowatt hour, the electricity price compensation, along with the so-called supercap, is to be extended as a compromise to the originally proposed bridging electricity price for companies on the so-called BesAR list, which was addressed by the Minister of Economics. On the other hand, the previously applicable peak compensation will expire, which previously reimbursed a large part (up to 90%) of the paid electricity tax for companies in the manufacturing sector. According to the Federal Government, total relief amounting to up to EUR 12 billion could be granted in the next year alone. In addition, all companies in the manufacturing sector will now benefit. Companies that previously used peak compensation could save on bureaucracy costs. The package is accompanied by other relief measures already decided upon by the Federal Government for stabilizing network fees through subsidies to transmission system operators.

Contact: sebastian.helmes@de.ey.com | tobias.teschner@de.ey.com

German tax authorities

Draft tax authority guidance on the interpretation of the German "Act to Combat Tax Havens" published for public consultation

On 30 November 2023, the German Ministry of Finance (BMF) issued draft guidance on the interpretation of the German "Act to Combat Tax Havens" (Steueroasen-Abwehrgesetz) for public consultation. This law, in force since 2021, has the aim of implementing the recommendations of the EU Code of Conduct Group concerning tax measures directed at non-cooperative jurisdictions and territories, as listed on the so-called *EU "Black List"*. Compared to other EU jurisdictions, Germany has implemented a wide range of measures that should deter from making investments in or having business relationships with black-listed jurisdictions. These are:

- A denial of deductibility of expenses made to recipients in black-listed jurisdictions (applicable 4 years after inclusion of a jurisdiction on the black list, i.e. from 2025 for the first group of black list members). The guidance clarifies that also depreciation amounts should be considered as such potentially non-deductible expense.

- A full imputation of low-taxed (i.e. below 15% ETR) CFC income generated in a black-listed controlled company to the German parent, regardless of the active or passive nature of the income generated abroad. This provision would already have applied since 2022 for CFCs in black-listed jurisdictions on the initial list, and will apply in the important case of Russia (expected to be subject to the black list restrictions based on a decree still to be issued this year by the German Ministry of Finance) from 2024.

- Withholding tax obligations over and beyond the already strict regular German rules, affecting payments on loans (except certain traded instruments), insurance premiums, service charges, trading in goods or services, and payments for German registered rights (even by non-German payors), in all cases where the recipient is resident in a black-listed jurisdiction. The guidance clarifies that asset rental payments and payments for the production of goods or supply of raw materials from the original producer are not subject to the WHT obligation. Payments made for public services (the example is given of a fee for the use of a shipping canal) shall not be deemed subject to the WHT on service payments. Further examples relevant for the financial services, asset management, shipping and tourism industries are given. This provision would already have applied since 2022 for CFCs in black-listed jurisdictions on the initial list, and will apply in the important case of Russia from 2024.

- Denial of the (generally 95%) participation exemption for corporate share capital gains and non-portfolio dividends for income directly or indirectly sourced from black-list corporate investments. This rule is applicable 3 years after inclusion of a jurisdiction on the black list, i.e. from 2024 for the first group of black list members.

- Extensive reporting obligations, also for transactions with non-related parties in black-listed jurisdictions, generally within 12 months after year-end.

Interested parties are asked to provide input on the draft guidance by 9 January 2024.

Photo: Bundesministerium der Finanzen / Photothek

Contact: christian.ehlermann@de.ey.com

BMF publishes guidance regarding tax treatment of so-called "side pockets" in case of an investment fund spin-off

In its letter dated 24 August 2023, the German Federal Ministry of Finance (BMF) published regulations on the tax treatment of asset transfers from an investment fund to a new investment fund through a spin-off. Precisely, the letter deals with the formation of so-called side pockets, which is permitted in some foreign jurisdictions, in which the assets of an investment fund are divided into tradable liquid assets and assets that are no longer tradable (illiquid assets) and a portion is transferred to a new fund. The fund with the illiquid assets is then regularly wound up.

The allocation of units in the new fund leads to a distribution in kind and further income in the liquidation phase. There is therefore a risk of a double tax burden. It is not possible to value the illiquid assets and the fund unit for the purpose of determining the advance lump sum. Daily valuation for the purposes of the equity rate to obtain the partial tax exemption is also not possible. The BMF essentially specifies that the distribution in kind of the units in the new fund is valued at EUR 0. Correspondingly, the units in the new fund are deemed to have been newly acquired at an acquisition cost of EUR 0 when the new fund takes up the illiquid assets. Accordingly, the acquisition date and costs of the original fund remain unchanged.

Photo: Bundesministerium der Finanzen / Photothek

If the liquid assets are transferred to the new fund, the latter takes over the acquisition date and acquisition costs of the original fund (Chapter 2 Investment Tax Act, InvStG), and the original fund is valued at an acquisition cost of zero and is deemed to be newly acquired.

The issue of illiquid assets has become particularly important for funds with an investment focus on Russia in the past year, as unit redemption had to be suspended for selected funds due to trading restrictions on Russian assets and a lack of liquid assets. One partially practiced solution to make at least the liquid part of the fund assets marketable again was the creation of "side pockets".

In deviation from the generally required tax treatment of the allocated units as a distribution in kind, the issue of units in the new fund does not result in capital gains.

Instead, the acquisition costs of the units of the fund holding the illiquid assets are to be recognized at EUR 0, while the previous acquisition costs remain fully allocated to the fund with the liquid assets. Taxation only takes place when the units are sold. The BMF's regulation is based on the treatment of foreign spin-off transactions for shares (Sec. 20 (4a) sent. 5 Income Tax Act, EStG). The units in the fund with the illiquid assets are deemed to have been newly acquired at the time of the spin-off and therefore regulations for old units and old units protected as existing units are not applicable to this fund. It is also advantageous that distributions and capital gains of the fund with the illiquid assets in the liquidation phase can be subject to the partial exemption rate of the original fund and the advance lump sum does not apply.

- **Contact: christian.ebner@de.ey.com**

German tax authorities

German reorganization tax rules: BMF publishes draft for an updated decree

On 11 October 2023 the Federal Ministry of Finance (BMF) published its draft decree for updated guidance on the application of the German reorganization tax law (so-called Umwandlungssteuererlass), which is an administrative "accessory" to the statutory regulations of the German Reorganization Tax Act (RTA), which implements the EU Merger Directive into German law. The updated decree contains clarifications and specifications with regard to the effective Reorganization Tax Decree of 11 November 2011. However, these content-related amendments are comparatively minor, while the focus has been on incorporating new legislative changes and decisions of the Federal Tax Court (BFH) over the course of the past twelve years.

For example, with the Act to Modernize Corporate Tax Law of June 2021, the requirement that the involved entities are EU/EEA companies for various types of tax-neutral reorganizations in the scope of the RTA was removed for tax transfer dates after 31 December 2021. Thus, the scope of application of the RTA has been opened for certain transformations of corporations domiciled in non-EU countries. This important change in the law has now been reflected in the new draft decree. Likewise, amongst other things, statutory references with regards to cross-border reorganizations are adjusted, as the underlying sections of the German Reorganization Act were amended earlier in 2023 by the German Reorganization of Companies Act (UmRuG). Then again, and much more importantly, no simplifying adjustments are made for foreign reorganizations with regards to the necessary comparability criteria for their comparison with a domestic reorganization to be in the scope of the RTA, although these have been demanded by practitioners for a long time. Instead, new specifics are added that confirm adherence to these.

Further, amongst other things, the BMF is including explanations regarding cross-border "outgoing" and "incoming" conversions of corporations into the decree, based on the ruling of the European Court of Justice (ECJ) of 2017 (C-106/16, "Polbud" case), which allows them to be carried out in a tax-neutral manner. Within the explanations concerning spin-offs, it is added – with regard to the often controversial question of the transfer of a "business unit" (so-called Teilbetrieb) – that assets which are used by several business units and are not split up should be allocated to the business unit in which they are predominantly used. Also in this case, simplifying adjustments or further clarifications are missing. Besides, referring to a BFH ruling, the BMF is adding the provision that a profit of the receiving corporate corporation within the meaning of Sec. 12 RTA is to be determined in all cases of upward, downward and sideways mergers or spin-offs – irrespective of a shareholding in the transferring corporation. This interpretation arguably has no basis in the law's wording.

The draft provides for a deadline for comments until 6 December 2023, thus the final new version of the decree is not expected to be published until 2024. EY Germany will also provide input to the BMF and request further changes.

- **Contact: daniel.kaeshammer@de.ey.com**

Photo: Bundesministerium der Finanzen / Photothek

German RETT and share deals: Double taxation under a new circular dealing with the attribution of properties?

A new circular dated 16 October 2023 creates a risk of a double German real estate transfer tax (RETT) charge on the same share transaction.

RETT can be triggered if shares in a real estate holding company are transferred or acquired. In simplified terms, RETT triggering share deals are:

Taxable event	Unification of shares	Transfer / movement of shares
Description	First-time unification of at least 90% of the shares in the hands of a single acquiror, directly and / or indirectly	Transfer of at least 90% of the shares within ten years, directly or indirectly (to new shareholders)
Triggering event	Signing of the SPA	Closing of the SPA
Underlying fiction	Acquisition of the real estate by the acquiror of the shares	Transfer of the real estate from an existing company to a deemed new company (note: legally the real estate holding company is still the same)
Liable person	Share acquiror	Real estate holding company

Based on the table above, it can be seen that a standard transaction (i.e. the acquisition of 100% of the shares in a real estate holding company) triggers both events. Historically, the understanding was that in such case, only the transfer / movements of shares should be taxable. However, at the end of 2022, the German RETT Act was modified. To avoid double RETT, the signing and the closing need to be notified to the tax authorities in a timely manner.

In addition to the above, on 16 October 2023, the tax authorities agreed on a new circular relating to the "attribution of properties". Such circular is highly relevant if shares in a parent company with a real estate holding subsidiary are transferred. RETT may then be triggered twice under the "transfer / movement" event, one time at the level of the subsidiary and a second time at the level of the parent. Whether or not RETT is triggered for a second time depends on whether the subsidiary was acquired by the parent at a point in time when it was already real estate holding (triggers RETT for the second time) or if the subsidiary acquired the real estate after the share acquisition by the parent (then no additional RETT is triggered). The background of such distinction is the logic as outlined in the table above, i.e. that the unification of shares in a real estate holding company results in a fictitious property purchase by the acquiror. Unlike in case of the signing / closing aspect as outlined in the paragraph above, the double RETT due to the fictitious property attribution to the parent cannot be avoided by timely notifications.

The new circular shall apply in all "open cases". For past transactions, we therefore recommend checking whether all notifications / disclosures have been properly made. Future transactions need to be carefully structured to secure triggering RETT only once.

For more details, please refer to our EY Tax Zoom *"New Guidance on attribution of properties for German RETT purposes"* dated 22 November 2023.

Contact: heinrich.fleischer@de.ey.com | thomas.wagner@de.ey.com

Tax groups in the case of reorganizations of the controlling corporation – question of financial integration

To form a tax group (fiscal unity) for income and trade tax purposes in Germany several conditions must be met, including the requirement for so-called financial integration of the tax group subsidiary into its parent. In effect, the parent must have held the shares in the subsidiary without interruption from the beginning of the financial year of the controlled corporation, granting a majority of the voting rights in the subsidiary.

The Federal Tax Court (BFH) now had to deal with the question of whether the financial integration is to be regarded as fulfilled at the level of the parent (as controlling corporation within the tax group) if there is a reorganization to/with the controlling corporation, e.g. the "old" controlling corporation is merged with another corporation, which then becomes the "new" controlling corporation. It is questionable whether this new parent corporation then fulfills the requirement that the "old" controlled corporation is deemed to be financially integrated into it from the start of its financial year. Especially cases in which the tax transfer date of the reorganization does not coincide with the beginning of the financial year of the controlled corporation led to many disputes with German fiscal authority.

The decisive factor here, also for the BFH, is that if a reorganization, e.g. a merger, is carried out within the scope of application, i.e. in accordance with the provisions of the German Reorganization Tax Act (UmwStG), the principle of "legal succession" (so-called "footstep theory") is applied. Consequently, according to the law, the receiving entity assumes the legal position regarding taxation of the transferring corporate entity, in particular regarding the valuation of the received assets, the allowances for depreciation and reserves reducing the profit determined for tax purposes. This also applies with regard to the controlling corporation characteristic and includes both the criterion of financial integration and the profit-pooling contract.

According to the BFH the acquiring corporation even assumes the already existing financial integration of the transferring corporation if the reorganization does (or could) not refer back to the beginning of the fiscal year of the controlled corporation (i.e., if it is not carried out with retroactive tax effect). It shall be sufficient if a financial integration of the controlled corporation first exists to the transferring corporation and later to the acquiring corporation. It is also irrelevant whether the "new" controlling corporation already legally exists at the beginning of the financial year of the controlled corporation. These rules also apply to qualified share-for-share exchanges, in which the transferee had filed an application for the shares to be recognized below the fair market value, which means that a tax group can be established during the year through share-for-share exchange, even if the law does not foresee the possibility of tax retroactivity for this type of reorganization (BFH rulings dated 11 July 2023 (I R 21/20, I R 36/20, I R 40/20 and I R 45/20)).

- **Contact: daniel.kaeshammer@de.ey.com**

Bundesfinanzhof, Foto: Andreas Focke

Federal Tax Court: No splitting of services in case of real property leasing connected with operating equipment

In its decision dated 17 August 2023 (V R 7/23 published on 7 September 2023) the German Federal Tax Court (BFH) follows the legal opinion of the European Court of Justice (ECJ) in the request for a preliminary ruling. Based on the ECJ decision, the BFH overruled previous German case law and held that the leasing of operating equipment in the context of VAT-exempt real property leasing is not subject to VAT but is also VAT-exempt where it constitutes an ancillary supply to a main supply of VAT-exempt real property leasing (so-called uniform supply).

While the leasing of immovable property is exempt from VAT under the regulation of Sec. 4 no. 12 sentence 1 lit. a) of the German VAT Act, the VAT-exemption does not apply to the leasing of operating equipment according to Sec. 4 no. 12 sentence 2 German VAT Act. In the past the BFH stipulated a requirement to split the VAT-exempt leasing of the property and the leasing of the operating equipment subject to VAT. The German tax authorities concurred with this splitting requirement and have published this view in the German VAT Application Decree.

In its recent decision the BFH follows the ECJ's legal opinion and clarifies that the VAT principle of "the unity of the supply" takes precedence over the splitting requirement. In case of a uniform supply the ancillary supply follows the VAT treatment of the main supply.

The case at hand concerned the leasing of a building for a turkey farm with permanently installed operating equipment. The BFH held that the leasing of the operating equipment is considered an ancillary supply to the VAT-exempt leasing of the property as the main supply and thus follows the VAT treatment of the real property lease.

This decision has significant implications for lessors and lessees, potentially affecting input VAT deduction and the contractual definition of lease agreements. Input VAT on equipment related expenses may no longer be deducted where the leasing is collectively classified as VAT-exempt. Lease agreements should be reviewed to assess whether there is a uniform VAT-exempt leasing or whether there are separate supplies to be assessed for VAT purposes.

It remains to be seen how the German tax authorities will react to this recent decision. Taxpayers with similar scenarios should check whether they can invoke the new case law and claim a beneficial treatment, even though the tax authorities' administrative guidelines still reflect the old principles.

- **Contact: martin.robisch@de.ey.com**

No deduction of import VAT for transport service providers for third-party goods

On 18 December 2020, the Federal Tax Court (BFH) issued a ruling confirming its latest decision: If a trader only provides a customs clearance or transport service in relation to the imported goods, they are not entitled to deduct import VAT as input VAT in their preliminary VAT return.

The decision not only confirms the latest European Court of Justice (ECJ) case law, but also the common interpretation of Sec. 15 Para 1 No.2 German VAT law, which emphasizes that the VAT deduction of import VAT is ultimately connected with the power of disposal in the decisive moment of import.

The dispute concerns the question whether the plaintiff, an indirect customs representative, is entitled to deduct import VAT as input tax. Indirect representation is typically used for companies that intend to import into the EU, but are not resident in the EU. Condition for declaring goods for import is that the declarant is resident in the EU. The peculiarity as to indirect representation in customs law is that the indirect representative takes over the role of importer for customs purposes, which implies that the indirect representative is treated as importer of record and, e.g, becomes subject to customs audits in the EU, in which imports for a non-EU company are reviewed.

In the case at hand the plaintiff had claimed the import VAT as input tax in their preliminary VAT return for March 2018. However, the tax office refused to deduct input VAT on the ground that the plaintiff had waived the remuneration for services and therefore the import VAT for the imported product was not a cost element of an output transaction. The BFH basically confirmed this view.

The plaintiff argued that the person liable for payment of the tax and the importer are sufficient to allow the VAT to be deducted and insofar also referred to an ECJ decision dated 8 October 2020 (Weindel Logistik Service, C-621/19), which had expanded the previous case-law. Their main argument was that the service and cost formula developed for the deduction of input VAT is not suitable for the import VAT as it arises under different conditions than VAT.

The BFH ruled that an interpretation of Sec. 15 (1) sentence 1 no. 2 of the German VAT Act in conformity with the EU VAT Directive makes it clear that a company can only claim input tax deduction if the imported goods are actually used for the taxable transactions of the company. This is for example the case if the trader uses the object themselves and uses its value for their turnover. However, if a service provider merely offers customs clearance or transport services in relation to the imported goods, no right of deduction applies since there is no connection to the actual economic sphere of their business.

Accordingly, the applicant is not entitled to deduct input VAT as they have not performed any related output supply.

The ruling is in line with general VAT principles and not surprising. The key takeaway for companies importing into Germany is that the power of disposal at the time of import and an ultimate connection of the imported good to the business sphere remains decisive.

Contact: frank-peter.ziegler@de.ey.com

BFH once again lowers threshold for existence of a permanent establishment

In a recent judgement the Federal Tax Court (BFH) deals with the question of the conditions under which foreign service providers can establish a domestic permanent establishment in foreign premises.

Whether a permanent establishment exists within the meaning of a Double Tax Treaty (DTT) depends, among other conditions, on whether the company is "rooted" in the place where the business activity is carried out. In its decision of 30 November 2017 (case ref. 1 K 123/17), the Saxon tax court ruled that such a nexus exists, for example, if an aircraft engineer is provided with a locker to store their tools as a subcontractor at the location of their maintenance contract. In this respect, the BFH also considers this to be a fixed establishment within the meaning of the DTT UK/Germany (BFH ruling of 9 January 2019, case ref. I B 138/17, NV).

In a recent judgement, the BFH had to decide a similar case involving an aircraft engineer based abroad. In its decision of 7 June 2023 (case ref. I R 47/20), the BFH confirmed the existence of a permanent establishment for the aircraft engineer as he had a personal locker in Germany to store his private clothing during working hours and work clothes during his free time. In this respect, according to the BFH, there was also no warehouse within the meaning of the DTT UK/Germany, which would exclude a permanent establishment under certain circumstances. Rather, the provision of the locker is sufficient to establish a "nexus" with the place of work even if no tools were actually stored in the locker (in contrast to the first case).

In light of these decisions, foreign service providers should carefully analyze whether their activities in Germany might trigger a permanent establishment.

- **Contact: klaus.bracht@de.ey.com**

BFH decides on the point in time when economic ownership of shares is acquired

In a decision dated 7 June 2023 (I R 50/19), the German Federal Tax Court (BFH) had to decide on the availability of the (effectively 95%) participation exemption for dividends received by corporate taxpayers with a minimum 10% shareholding. In the facts of the case, the dividend recipient, a German GmbH, had acquired shares (and all associated rights) bringing its shareholding in a German AG over 10% through a binding agreement in December 2013. However, the completion of the sale remained under the condition precedent of full payment of the purchase price, which in the given case only occurred in January 2014. This led the German tax auditor to deny the participation exemption for dividends received by the GmbH in 2014, as at that time, German law required a 10% shareholding to exist from the beginning of the year. The taxpayer successfully argued that in the case at hand, while legal ownership of the shares undoubtedly had only been transferred at the time of fulfilment of the condition precedent for closing (the payment of the purchase price), the economic transfer of the shares, which was decisive for allocating the shares from a tax perspective, already had occurred at signing, i.e. in December 2013. Thus, the conditions for the participation exemption for dividends were met in 2014.

The court came to its conclusion because the share purchaser obtained already in 2013 a definite right to obtain the shares (and all rights associated with them), which could no longer be taken away without the purchaser's consent, and the buyer could effectively control the moment when the share transfer became effective by fulfilling the last remaining closing condition (payment of purchase price). Thus, on balance, the GmbH could be considered economic owner of the shares from the moment of signing the purchase agreement.

- **Contact: christian.ehlermann@de.ey.com**

BFH voices doubts whether the German CFC rules are in line with Constitutional and Union Law due to 25% threshold for low taxation

In its decision dated 13 September 2023 (I B 11/22) in a procedure for preliminary legal protection, the German Federal Tax Court (BFH) expressed serious constitutional and EU law doubts about the currently applicable German CFC low tax threshold of 25%.

Under German CFC-rules, passive income of a controlled foreign company (CFC) is generally subject to imputation at the level of its German (indirect) shareholder if the foreign income is subject to low taxation, i.e. an income tax burden of less than 25%. In Germany, the lowest national total tax burden for domestic taxpayers including the solidarity surcharge, is 15.825% (excluding trade tax). Including trade tax at a statutory "minimum assessment rate" of 200% results in a lowest national total tax burden of 22.825%.

As the CFC low tax threshold of 25% significantly exceeds the lowest national total tax burden, the BFH has now confirmed in a procedure for preliminary legal protection the constitutional and EU law doubts already expressed by the prevailing opinion in the literature.

According to the BFH, the low tax threshold can no longer be objectively justified by the legislative intention of "achieving unjustified tax advantages" due to the lack of "compensatory foreign taxation". The Court further noted that the 25% threshold for low taxation could also lead to deficits in terms of crediting the foreign tax, particularly if the imputation amount is allocated to a domestic corporation (and would therefore be subject to trade tax), which could also be conflicting with the EU ATAD Directive, requiring a full credit of the foreign taxes imposed on the passive income.

According to the Court, the constitutional doubts could be eliminated by a legislative reduction of the low tax threshold to 22.825% or 15.825%. However, as in the case at hand the passive income of the foreign CFC was subject to zero taxation in the specific case (assessment year 2016), the applicant would not benefit from a favorable legal situation even then. The same applies with regard to the violation of EU law already recognized by the BFH in previous case law. The appeal was therefore unsuccessful in this specific case. The decision is of particular relevance for taxpayers subject to imputation where the foreign CFC is subject to a taxation of more than 22.825% or 18.285%. The Court did not take a final position with regard to this threshold indicating a conflict with Constitutional or Union law.

The doubts expressed by the BFH are likely to be remedied in the future with the reduction of the AStG low-tax threshold to 15% intended by the legislator as part of the Minimum Taxation Directive Implementation Act.

- **Contact: stefan.m.mueller@de.ey.com**

German court decisions

BFH clarifies requirements for recognizing deferred income

Deferred income (PRAP) must generally be recognized if a payment received in the previous year represents economic income for a "certain period" after the balance sheet date. According to the German Federal Tax Court (BFH), an estimate of this period is permissible if it is based on generally applicable standards. Such standards are lacking if the standards are based on the taxpayer's organizational decisions.

The requirement to recognize deferred income serves to record expenses and income on an accrual basis. By recognizing deferred income, the recognition of a payment received in advance in the income statement can be postponed to the time at which the consideration is received if the consideration represents income for a certain period after the balance sheet date. The consideration must be time-related or periodically divisible. This is not the case if the time standards are based on the taxpayer's decisions, which are at his discretion. This was decided by the BFH in a recently published judgement (decision of 26 July 2023, case ref. IV R 22/20).

In the underlying case a construction project development company had accounted for deferred income for flat-rate activity fees received in monthly instalments. The construction company collected regular instalments on the total contract amount over the expected term of the respective project irrespective of the specific construction progress, whereby future construction progress was at its discretion. In the opinion of the BFH the specific time after the balance sheet date was no longer based on generally applicable standards.

A deferred income item or, alternatively, the recognition of advance payments received for services still outstanding as liabilities is therefore only possible if there is documentation or contractual arrangements relating to the specific progress of construction in individual cases.

Contact: klaus.bracht@de.ey.com

Federal Tax Court rules on deductibility of takeover loss resulting from a merger

In its judgement dated 17 August 2023 (case reference III R 37/20), the German Federal Tax Court (BFH) addressed the question whether a takeover loss resulting from a merger of a GmbH into an individual business remains non-deductible even if the shares of the transferor have only been legally acquired by the transferee after the tax effective merger date.

The case focused on the consequences of a 2016 merger, where the plaintiff, who operated an individual business, acquired shares in a GmbH. This merger was executed with tax retroactivity to 31 December 2015, which was considered the tax effective transfer date. At the center of the dispute was a resulting takeover loss, primarily due to the low valuation of pension provisions in the tax balance sheet. In its 2015 income tax return, the plaintiff sought to deduct this takeover loss. However, the competent tax office denied the deduction entirely.

The BFH upheld the tax office's view, confirming that the loss was not deductible. This interpretation stemmed from Sec. 4 Para. 6 Sent. 6 Alt. 2 of the Reorganization Tax Act (RTA), which stipulates that a takeover loss is entirely disregarded if the shares of the transferring corporation were acquired within the last five years before the tax transfer date. Although the shares in the GmbH were only actually acquired in 2016 (that is, after the tax transfer date of 31 December 2015), the court applied the fiction of Sec. 5 Para. 1 of the RTA. This rule determines the profit of the transferee as if it had acquired the merged shares at the tax transfer date, thus rendering a fictitious share acquisition within the last five years, which was consequently considered detrimental to the loss deduction. ▸

Furthermore, the BFH ruled that the relevant rules should not be interpreted based on the law's intent in cases of losses stemming from the low tax balance sheet valuation of pension provisions. The court was also not convinced of the constitutional invalidity of these provisions. The plaintiff failed to substantiate a claim of constitutional or equality violation due to specific multiple or double taxation.

In a nutshell, this case highlights the stringent application of German tax laws, especially in the context of mergers and acquisitions. It underscores the challenges in claiming tax deductions for takeover losses under German tax law and emphasizes the importance of adhering to specific valuation methods prescribed by law, particularly for pension provisions in such transactions.

- **Contact: joerg.s.brodersen@de.ey.com**

Admissibility of retroactive customs duty assessments in the event of upward transfer pricing adjustments

For several years, there has been uncertainty regarding whether the Articles 28 to 31 of the Community Customs Code (and its subsequent rules in the Union Customs Code) are to be interpreted in a way that they do not allow the customs value to be taken based on the primary method (transaction value method) if the price consists of an amount initially invoiced and declared plus a flat-rate adjustment at the end of the accounting period.

In addition to the questions addressed and answered by the European Court of Justice (ECJ) in the well-known Hamamatsu case (case ref. C 529/17, decision dated 20 December 2017), which was subsequently then also decided by the Federal Tax Court (BFH, VII R 2/19 of 17 May 2022), more questions arose, one of which is about to be decided in due course (i.e., expected in the next 12 months). The Hamamatsu decision of the BFH concerned customs duty refunds arising from transfer pricing adjustments in the form of lump-sum credits. Both the ECJ and the BFH clarified in their judgements that the Customs Code does not allow taking into account a subsequent adjustment of the transaction value, such as that at issue in the main proceedings. Based on this rationale, no refund of customs duties was granted.

Although the wording of the decision affected customs valuation principles, the German customs authorities decided to only apply it to lump-sum adjustments (not for product-specific adjustments contractually agreed prior to import) and only for the case of downward adjustments assuming that upward adjustments (i.e., debit notes issued by the seller to the buyer) imply that the initial price had been influenced by the relationship of the parties. In essence, the German customs authorities applied the rationale of the decision strictly for refunds, but not in case of potentially levied additional customs duties.

In a current case, the BFH (VII R 36/22) now has to decide on a decision of the Munich tax court (14 K 88/20 of 27 October 2022) which has been appealed by the German customs authorities.

At issue is the customs value of the goods imported by the plaintiff. They were purchased from an undertaking related to the plaintiff and imported into Germany. The plaintiff had paid additional debit amounts (transfer pricing adjustments) to the affiliated company supplying the goods.

The lower court had based its decision on the principles derived from the Hamamatsu case, i.e. that retroactive adjustments intended to mitigate corporate tax and transfer pricing risks are not to be considered in the customs value.

It will be interesting to see if the BFH will adhere in this case to the customs valuation principles established in the Hamamatsu case. In our opinion, these principles should apply for refund and additional assessment cases similarly. However, even if the BFH decides in favor of the importer, the German customs authorities could still attempt to assess additional duties by challenging whether the initial price complied with arm's length considerations.

- **Contact: frank-peter.ziegler@de.ey.com**

Case law highlights potential risks from German place of management for asset-managing foreign entities

Two recent court cases illustrate the risk for asset managers using foreign-registered or insufficiently locally managed entities holding German investments (e.g. real property or shareholdings) if insufficient evidence exists that the relevant holding entities are managed from abroad, and not from Germany.

The Federal Tax Court (BFH) was asked to decide in a case (decision of 23 March 2022, III R 35/20) where a GmbH with a Luxembourg-based managing director held German real property and claimed a specific exemption from German trade tax that is available only to nonresident entities without a German permanent establishment. At the same time, it had subcontracted a Germany-based advisory GmbH to handle all administrative matters related to the property on its behalf. The court referred the case back to the lower tax court to verify whether there factually was a place of management for the claimant in Germany, or a management fixed place of business/permanent establishment. According to the BFH, the latter could be the case where there was identity of management between the asset-holding entity and the German advisory vehicle, or where personnel of the asset-holding entity factually supervised the German advisory entity's personnel at its German premises. The recently published decision of the lower tax court (court of Berlin-Brandenburg, decision of 28 June 2023, 11 K 11108/17) came to the conclusion that the factual place of management of the asset-owning GmbH was in Germany, despite the managing director's residence in Luxembourg, as the taxpayer could not document that decisions of day-to-day management for the entity were actually taken by the managing director in Luxembourg rather than at the German location of the advisory entity. As a consequence, the property GmbH was regarded as resident in Germany, also from a tax treaty perspective, and hence ordinarily taxable on its income.

In another case (Munich tax court, decision dated 5 June 2023, 7 V 94/23), a Jersey-registered asset-managing Ltd. was upon audit found to be managed and controlled from Germany and hence Germany-resident, despite the existence of locally based directors. Decisive for the court's judgment was the lack of independent judgment authority exercised by the local, Jersey-based directors, who in practice had to follow instructions by the Germany-based fund initiators. The tax authorities, as part of a tax fraud investigation, could establish that relevant governance documents for the Jersey Ltd. were prepared and stored on servers in Germany, and that communication with the shareholders of the Jersey Ltd. (the fund investors) was carried out directly by the German residents. As a consequence of the Jersey Ltd. thus becoming a German tax resident, it was held liable for German withholding tax on distributions made to its investors (26.375%).

These cases highlight the need for careful documentation that day-to-day management of foreign asset-managing or other special purpose entities is indeed carried out outside of Germany. The definition of what such "day-to-day management" is will very much depend on the relevant entity's scope of business and will hence need to be reviewed individually. Contrary to other jurisdictions, Germany does not have an exemption from its domestic permanent establishment definition for asset management activities, so that also in this context, prudence is recommended, should one want to avoid tax nexus risks.

Contact: christian.ehlermann@de.ey.com

German court decisions

Münster tax court rules on partnership double deduction rule in fiscal unity cases

In 2021, Germany introduced general anti-hybrid rules (Sec. 4k Income Tax Act, EStG) based on the OECD Action 2 proposal and the ATAD I and II wording. The rules (partially) deny deductions on expenses accruing after 31 December 2019 in hybrid mismatch situations (deduction/non-inclusions, double deductions, imported mismatches).

Already for expenses accruing after 31 December 2016 Germany had introduced an anti-hybrid rule exclusively aiming to deny double deductions in inbound partnership structures (Sec. 4i EStG – partnership double deduction rule). In such structures double deductions can arise due to Germany's specific partnership taxation regime, which expands the trade or business of the partnership to assets or liabilities of the partner with a nexus to the partnership. If e.g. a partner grants a loan to a partnership, the partner's receivable is allocated to the partnership's trade or business and the interest income becomes subject to income taxation in Germany (if required, under a treaty override). Correspondingly, interest expenses of a partner that accrue on debt assumed by the partner to fund the partnership are generally tax deductible in Germany. The partner's residency country typically does not follow this allocation also allowing for a deduction of the same interest expense. The partnership double deduction rule was introduced to prevent the double deductions in such situations.

The Münster tax court (case reference 10 K 2613/20 F, decision dated 31 August 2023) had to decide whether such a double deduction exists where the debt was granted to a Dutch partner by its Dutch parent within a fiscal unity ("fiscale eenheid") between the two Dutch entities. The Dutch partner recognized interest expenses for statutory accounting purposes. But the loan was, by way of consolidation, disregarded for Dutch tax purposes due to the existing fiscal unity. The Münster tax court held that there was no double deduction for purposes of the partnership double deduction rule. A deduction requires the reduction of the taxable income of the Dutch partner. As the loan was completely disregarded for Dutch tax purposes, the Dutch partner did not incur tax deductible interest expenses. Its taxable income thus remained unaffected. The Münster tax court also explicitly held that both (i) the statutory accounting recognition of the interest expenses and (ii) the tax effects at the level of the Dutch parent were irrelevant for purposes of the partnership double deduction rule. The Münster tax court allowed the appeal to the Federal Tax Court (BFH).

The Münster tax court decision supports interest deductions in comparable structures on expenses accrued in FY17 to FY19. However, the income consolidation method in the respective tax group regime must be carefully assessed. In addition, from FY20 onwards Germany's general, more comprehensive anti-hybrid rules must also be considered when assessing the deductibility of interest expenses in inbound partnership structures.

Contact: ivo.schmohl@de.ey.com | konstantin.eckel@de.ey.com

Local tax court of Munich applies ECJ jurisprudence on final losses incurred in EU PEs also to currency losses of a foreign PE

In its decision dated 10 July 2023 (case reference: 7 K 3340/18), the tax court of Munich decided that final currency losses which are attributable to a foreign permanent establishment (PE) on which the exemption method applies, are not deductible at the level of the German head office. It thereby applied the recent jurisprudence of the European Court of Justice (ECJ) on final PE losses to currency losses of a foreign PE.

In the case at hand, the Irish PE of a German head office reported the capital allocated to it ("Dotationskapital") in Irish Pounds while the domestic head office reported in German Marks. Since its establishment in 1972 the PE incurred currency losses until the changeover to the Euro and these losses became final when the PE was sold later. The German tax authorities denied the deduction of these currency losses at the level of the head office arguing that since the profits of the PE were exempted under the exemption method, also its currency losses cannot be considered. The taxpayer argued that such currency losses were to be recognized according to the ECJ decision in "Deutsche Shell" (decision dated 16 December 2009, case C-293/06) and that the recent decision of the ECJ on final losses, "Timac Agro Deutschland" (decision dated 17 December 2015, case C-388/14, confirmed by "W AG", decision dated 22 September 2022, case C-538/20) was not applicable in the given case as that decision did not deal with currency losses. The local tax court of Munich did not follow the taxpayer's argument and held that under the current ECJ jurisprudence Member States are not obliged to take into account final currency losses of a PE thereby specifically referring to an ECJ decision on currency losses in a Swedish case where the ECJ held that Union law does not oblige a Member State to recognize currency losses from a sale of share if capital gains from such a sale would have been tax exempt ("X", decision dated 10 June 2015, case C-686/13).

The taxpayer lodged an appeal against the decision of the tax court. This will allow the Federal Tax Court (BFH) to comment on the question of whether the principles of its most recent decisions also apply to currency losses and whether the case law of the ECJ in "Deutsche Shell" is outdated in this respect.

- **Contact: stefan.m.mueller@de.ey.com**

The EU's Carbon Border Adjustment Mechanism in a nutshell

The Carbon Border Adjustment Mechanism (CBAM) is the European Union's plan to introduce a border adjustment levy on greenhouse gases (mainly, but not exclusively, CO_2) generated during the production of goods in third countries. The CBAM aims to ensure that products imported from countries that have no or low carbon prices are taxed in the same manner as similar products produced in the EU which are subject to the CO_2 price in the EU Emissions Trading System (ETS) upon EU manufacture. The levy should encourage other countries to decarbonize and reduce the EU's risk of "carbon leakage", which occurs when carbon-intensive production moves away from the EU to countries where less stringent climate policies are in place, or when EU products are replaced by more carbon-intensive imports.

Hence the levy has implications for many exporters to EU member states. Importers into the EU have to identify all CBAM covered products and track all the relevant imports of iron, steel, aluminum, fertilizer, concrete, hydrogen and electricity for their first CBAM report. Ideally, operators should communicate the data for the full year 2023 to importers in January 2024 for the first quarterly report. The CBAM transition period will run until the end of 2025.

From 2026 the importer will need to have an authorization as authorized CBAM declarant and buy CBAM certificates to offset the cost of the embedded carbon and other greenhouse gas emissions. A deduction of the price is possible if carbon prices/taxes were already paid in the country of origin. In addition, the CBAM reports will need to be independently verified by an accredited verifier from 2026.

The CBAM record keeping and reporting requirements rely on a mix of product data, customs-related data and calculated embedded carbon emissions data. The latter will only be available upstream in the supply chain itself. This will be a significant challenge for all affected businesses.

To comply with CBAM, companies will face organizational as well as implementation challenges. The data needed will most likely either not have been gathered yet or be scattered across different stakeholders in the supply chain and different data sources. It is important to note that CBAM is a cross-functional challenge and typically requires collaboration of group/local customs function, procurement, ESG function and operations/ supply chain teams as well as external upstream suppliers. Challenges will be in particular the tracking of imports of CBAM products into the EU, data collection for embedded emissions, engaging with suppliers, higher costs (future costs for CBAM certificates) and registering and/or preparing the appropriate legal entities to comply with the formal requirements.

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Contact: richard.j.albert@de.ey.com

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EY German contacts

Cities in alphabetical order

Friedrichstraße 140
10117 Berlin
Phone +49 30 25471 0
Telefax +49 30 25471 550

Lloydstraße 4–6
28217 Bremen
Phone +49 421 33574 0
Telefax +49 421 33574 550

Westfalendamm 11
44141 Dortmund
Phone +49 231 55011 0
Telefax +49 231 55011 550

Forststraße 2a
01099 Dresden
Phone +49 351 4840 0
Telefax +49 351 4840 550

Graf-Adolf-Platz 15
40213 Düsseldorf
Phone +49 211 9352 0
Telefax +49 211 9352 550

Mergenthalerallee 3–5
65760 Eschborn/Frankfurt/M.
Phone +49 6196 996 0
Telefax +49 6196 996 550

Wittekindstraße 1a
45131 Essen
Phone +49 201 2421 0
Telefax +49 201 2421 550

Bismarckallee 15
79098 Freiburg
Phone +49 761 1508 0
Telefax +49 761 1508 23250

Rothenbaumchaussee 78
20148 Hamburg
Phone +49 40 36132 0
Telefax +49 40 36132 550

Landschaftstraße 8
30159 Hannover
Phone +49 511 8508 0
Telefax +49 511 8508 550

Titotstraße 8
74072 Heilbronn
Phone +49 7131 9391 0
Telefax +49 7131 9391 550

Börsenplatz 1
50667 Cologne
Phone +49 221 2779 0
Telefax +49 221 2779 550

Grimmaische Straße 25
04109 Leipzig
Phone +49 341 2526 0
Telefax +49 341 2526 550

Theodor-Heuss-Anlage 2
68165 Mannheim
Phone +49 621 4208 0
Telefax +49 621 4208 550

Arnulfstraße 59
80636 Munich
Phone +49 89 14331 0
Telefax +49 89 14331 17225

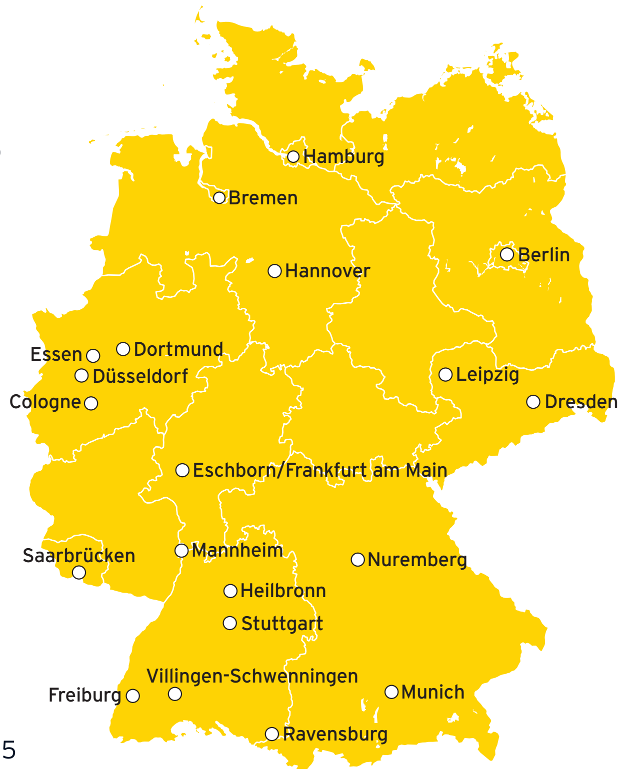
Am Tullnaupark 8
90402 Nuremberg
Phone +49 911 3958 0
Telefax +49 911 3958 550

Gartenstraße 86
88212 Ravensburg
Phone +49 751 3551 0
Telefax +49 751 3551 550

Heinrich-Böcking-Straße 6–8
66121 Saarbrücken
Phone +49 681 2104 0
Telefax +49 681 2104 42650

Flughafenstraße 61
70629 Stuttgart
Phone +49 711 9881 0
Telefax +49 711 9881 550

Max-Planck-Straße 11
78052 Villingen-Schwenningen
Phone +49 7721 801 0
Telefax +49 7721 801 550



EY German Tax Desks

London
Phone +44 20 7951 4034

New York
Phone +1 212 773 8265

Shanghai
Phone +86 21 2228 6824

Tokyo
Phone +81 3 3506 2238

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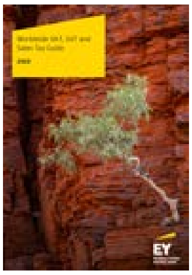

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Wirtschaftsprüfungsgesellschaft
Flughafenstraße 61
70629 Stuttgart

Editorial Team
Christian Ehlermann, christian.ehlermann@de.ey.com
Joerg Leissner, joerg.leissner@de.ey.com

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