German Tax Monthly

Information on the latest tax developments in Germany

May | 2022

Revision of the Coordinated Decree of German Federal States on Trade Tax Add-back

According to German tax law, every business entity operated domestically is subject to trade tax. Trade tax is assessed on the basis of profit for trade tax purposes, which is initially determined according to the provisions of the German Income Tax Act or Corporation Tax Act, depending on the legal form of the business operation. For trade tax purposes, however, this profit is increased in a second step by certain add-backs (so-called trade tax add-backs). For example, part of the rental and lease expenses for moveable and immovable fixed assets is added back to profit. Whether an asset is considered fixed must be determined from the perspective of the renter or lessee. The question is whether the asset would be regarded the renter's/lessee's fixed asset if s/he were its owner (so-called notional fixed assets).

In a coordinated decree of 2 July 2012, the highest tax authorities of the German federal states commented on the trade tax add-backs. This decree has now been amended on 6 April 2022 as follows in response to a judgment handed down in the meantime.

- No add-back when expenses are activated:
  Rental and lease expenses can only be added back if they have been deducted when determining the profit. Expenses that were activated on the reporting date as cost of fixed or current assets are therefore not added back. For example, according to German accounting law, lease expenses for machinery are part of the production cost of the asset manufactured with the machinery. The decree now contains two clarifications in this regard:
  - Even in the case of assets that were already retired during the year, expenses that would have been activated as cost if the asset had still been part of operating assets on the reporting date are not added back;
  - However, expenses incurred in connection with the production of an internally generated intangible asset must always be

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added back due to the prohibition on capitalisation (Section 5 (2) German Income Tax Act [EStG]).

- Existence of notional fixed assets:
  According to case law, the business purpose of the entity must be taken into account when examining whether notional fixed assets exist. The question is whether the business purpose requires the permanent holding of such assets in the individual case. It does not, however, depend on the duration of the rental, meaning that an asset can also be a notional fixed asset if it is only rented for a short period of time.

  This has now been upheld by the decree, which states that whether an asset is considered a notional fixed asset depends on the respective specific business purpose in the individual case.

- Reference to four BFH judgments:
  The decree follows the guiding principles of four BFH judgments on the issue of the existence of notional fixed assets in the case of rental and lease expenses in certain cases. For example, the event real estate rented by a concert organiser is to be allocated to its notional fixed assets, as these assets are to be held permanently for use according to the business purpose.

The amendments are to be applied to all cases still open under procedural law.

Lower Tax Court of Münster (4 K 1512/15 F): Contribution gain II due to Change of Legal Form

The Lower Tax Court of Münster ruled on 30 December 2021 that a change of legal form of a limited liability company [GmbH] into a limited partnership [KG] immediately after a qualified exchange of limited liability company shares within the meaning of Section 21 (1) sentence 2 of the German Reorganization Tax Act [UmwStG] triggers a contribution gain II.

According to marginal ref. 22.23 of the German Tax Decree on Transformations [UmwSt-Erlass] 2011, any transformation (reorganisation) or contribution (transfer) by both the transferring company and the acquiring corporation following a contribution to a corporation, as well as the transfer of restricted shares as a result of the transformation, leads to a disposal within the meaning of Section 22 (2) sentence 1 UmwStG. The taxation of gains arising from contributions (contribution gain) can only be waived for reasons of equity if the specific individual case is comparable in all respects with the exemptions under Section 22 (1) sentence 6 nos. 2, 4 and 5 UmwStG.

In the case under dispute, a qualified exchange of shares pursuant to Section 21 (1) sentence 2 UmwStG was followed in 2010, on the same day, by a change of the legal form of a corporation (whose shares were contributed as part of an exchange of shares) into a partnership.

In dispute was whether this procedure triggers a contribution gain II within the meaning of Section 22 (2) UmwStG 2006 (superseded version) and, if so, whether a different assessment of tax bases should be considered for reasons of equity in this respect.

The Lower Tax Court concurs with the opinion of the tax authorities and affirms that in the case in dispute there is taxation of contribution gain due to the change of legal form. This could also not be avoided for reasons of equity, as a change of legal form is not comparable in all respects with the exemptions under Section 22 (1) sentence 6 nos. 2, 4 and 5 UmwStG. In the case of a change of legal form into a partnership, the target legal form, as a fundamental characteristic of a transformation transaction, already deviates from the transactions specified in Section 22 (1) nos. 2, 4, 5 UmwStG.

Moreover, the Lower Tax Court has reservations as to whether a tax assessment or determination in deviation of legal requirements would be permissible at all based on marginal ref. 22.23 UmwSt-Erlass 2011. In the case under dispute, however, it was no longer necessary to make a final decision on whether the UmwSt-Erlass 2011 is in line with the principle of administrative legality in this respect, although it contains typifying, subsumable regulations.

The appeal against the decision of the Lower Tax Court of Münster is pending before the German Federal Tax Court under file number I R 10/22.

European Court of Justice (ECJ), Opinion of 10 March 2022 (C-538/20): Deduction of Definitive Losses incurred by an Exempt Permanent Establishment under EU Law

In a reference for a preliminary ruling procedure submitted to the ECJ, the German Federal Tax Court (BFH) had requested clarification on whether the European freedom of establishment would require losses disregarded in the United Kingdom due to the closure of the permanent establishment in that country to be considered as definitive losses and thus have a tax-reducing effect on the

tax base in Germany. The questions of the BFH referred for a preliminary ruling have now been answered by Advocate General at the ECJ Collins as part of his proposed decision of 10 March 2022.

At the centre of the request for a preliminary ruling was the question of whether in cases of permanent establishments exempted under a double taxation treaty (DTT), where the State in which the parent company is located exempts the income of the non-resident permanent establishment as a whole from taxation by virtue of a bilateral agreement, there is at all a necessary objective comparability of the situations within the meaning of ECJ case law.

This disputed subject dates back to the landmark ruling of 13 December 2005 "Marks & Spencer" (C 446/03), in which the ECJ established the construct of definitive losses for the first time. In the past, the ECJ in its judgment on the Timac Agro case (17 December 2015, C-388/14) – and the BFH in its implementation ruling of 22 February 2017, I R 2/15 – had initially rejected consideration of a permanent establishment's definitive losses. However, in its more recent ruling in 2018 on the Bevola/Trock case (12 June 2018, C-650/16), the ECJ then stated to the contrary that EU law does require definitive losses to be considered.

The Advocate General has for the first time put these supposedly contradictory ECJ statements into an overall context and differentiates as follows. Objective comparability of the taxation situations of resident and non-resident permanent establishments only exists if the State in which the parent company is located is authorised to tax the non-resident permanent establishment's income. However, this is not the case if the parent company state and the non-resident permanent establishment state have bilaterally agreed by way of a DTT that the parent company state has actually and completely waived its authority to tax the permanent establishment's income.

If the ECJ follows the Advocate General's comments with regard to the lack of objective comparability in DTT exemption cases, then the additional questions referred by the BFH to the ECJ regarding the structure and extent of final losses incurred by a permanent establishment are no longer relevant.

The ECJ is not bound by the Advocate General's opinion. It remains to be seen whether the Court will adopt the Advocate General's proposed decision in this case.

UPDATE: Special Coronavirus Rules for Cross-Border Commuters

In the interim, various consultation agreements between Germany and its neighbouring countries have been extended for the last time until 30 June 2022 or terminated with effect from this date.

The coronavirus pandemic presents particular challenges for cross-border commuters who normally commute daily from their country of residence to work in another country. For this reason, the German Federal Ministry of Finance [BMF] has concluded temporary consultation agreements with neighbouring countries for cross-border commuters in order to prevent salaries and wages from becoming taxable in the country of residence of the cross-border commuters due to working from home. Accordingly, working days for which salary or wages are received and on which cross-border commuters only work from home because of measures to combat the coronavirus epidemic are considered working days spent in the contracting state in which the employees would normally have carried out their work. The agreements in general apply to working days from 11 March 2020.

The measures taken in response to the COVID-19 pandemic have been largely lifted in most countries. By mutual agreement, Germany and several of its neighbouring countries have therefore now agreed to also phase out the consultation agreements.

Here is an overview of the existing consultation agreements and their periods of validity:

- Austria, Switzerland
  The agreements with Austria and Switzerland were for the last time extended until 30 June 2022 respectively terminated with effect from the end of 30 June 2022. The two agreements also apply to public sector employees and both include an explanation of situations when a home office is considered a permanent establishment.
- Luxembourg, Poland
  This consultation agreements with Luxembourg and Poland were terminated with effect from 30 June 2022. Likewise, they are also applicable to public sector employees.
- The Netherlands, France and Belgium
  The agreements with the Netherlands and France were terminated with effect from 30 June 2022. The agreement with Belgium was for the last time extended until 30 June 2022.

Imprint

Published by
KPMG AG Wirtschaftsprüfungs-gesellschaft
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60549 Frankfurt/Main, Germany

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