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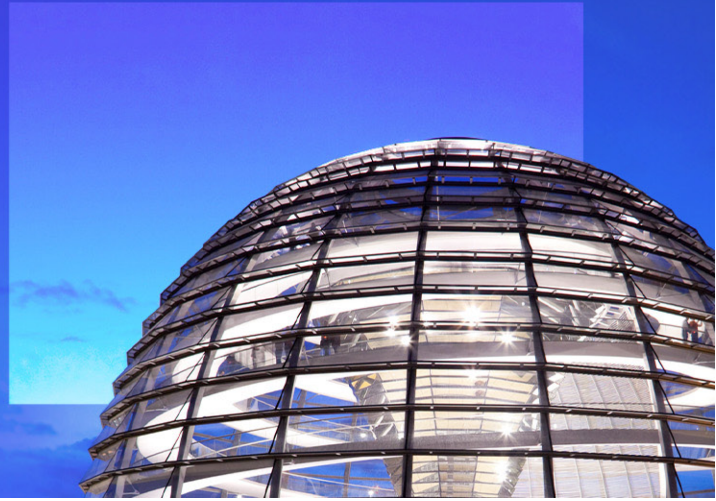

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Discussion Draft for an Act to implement the EU Minimum Taxation Directive

On 20 March 2023, the Federal Ministry of Finance (BMF) published a discussion draft for an "Act for the implementation of the EU Directive to ensure a global minimum taxation for multinational groups of companies and large domestic groups in the European Union" (Minimum Tax Directive Implementation Act). The discussion draft is closely based on the so-called Minimum Taxation Directive of the EU (Council Directive (EU) 2022/2523 of 15 December 2022) and the OECD model regulations and will transpose the Directive into national law. The objective is to implement central elements of the international agreements on Pillar 2 (rules on minimum taxation) of the OECD's two-pillar solution. If the minimum taxation limit of 15 percent is not reached, the top-up tax instruments developed under Pillar 2 take effect, which are intended, among other things, to ensure a global effective minimum taxation.

The relevant rules will be defined in Germany in a completely new tax act, the Minimum Taxation Act. This discussion draft considers the GloBE Model Rules (Global Anti-Base Erosion Model Rules, developed by the OECD Inclusive Framework on BEPS in 2021), the OECD´s Commentary on these model rules (from March 2022) as well as the further international work as part of the GloBE Implementation Framework, especially the rules for “safe harbours” (from December 2022).

The tax subjects are business units located in Germany. The relevant criterion is that the group to which a business unit belongs reports annual revenue of EUR 750 million or more in the consolidated financial statements of the ultimate parent entity in at least two of four fiscal years immediately preceding the tested fiscal year (revenue limit). The rules cover groups with international activities and groups with domestic activities. However, there is a 5-year tax exemption for groups with minor international activities (business units in no more than six jurisdictions and whose foreign business units' tangible assets do not exceed EUR 50 million).

The minimum tax is composed of the “primary supplementary tax” (Income Inclusion Rule – IIR), the “secondary supplementary tax” (Undertaxed Payment Rule – UTPR) and the “national supplementary tax” (Qualified Domestic Minimum Top-up Tax – QDMTT). The UTR is to be applied subsidiarily to the IIR and serves as a catch-all measure, if the low taxation is not already compensated by the application of the IIR.

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The IIR top-up tax amount and the UTPR top-up tax amount correspond to the share of the top-up tax amount of a low-taxed business unit attributable to a taxable entity. The QDMTT amount corresponds to the top-up tax amount allocated to the business unit as determined for Germany. The minimum tax is calculated – country-specific calculation of the top-up tax amount using a minimum tax rate of 15 percent – based on GAAP (typically the accounting standard of the ultimate parent entity) and specific necessary adjustments.

The draft also includes the internationally agreed simplifications, especially the transitional CbCR safe harbour (the use of country-by-country reporting of multinational groups), relief for insignificant business units, as well as the safe harbour rule for QDMTT, which is not limited to EU Member States and also applies for third countries.

The taxation is carried out in the form of a kind of self-assessment (submission of tax return with self-calculation of the tax). In addition, a minimum tax report is to be submitted to the German Federal Central Tax Office, serving (among other things) for purposes of international exchange of information.

The Minimum Taxation Act will generally be first applicable for fiscal years beginning after 30 December 2023. There is an exception for the undertaxed profit rule, which will first be applicable to fiscal years beginning after 30 December 2024. The exception will not apply for groups whose ultimate parent entity is located in EU Member States that have exercised the option according to Article 50 (1) of Directive (EU) 2022/2523. Article 50 (1) of Directive (EU) 2022/2523 allows a Member State from 31 December 2023 to delay application of the IIR and an UTPR for six consecutive fiscal years if no more than twelve ultimate parent entities of groups within the scope of Directive (EU) 2022/2523 are located in that Member State.

Before the official legislative process begins, the German Federal Ministry of Finance will grant "interested experts" the opportunity to comment on the draft until 21 April 2023. The ministerial draft is expected to be published subsequent to this. Once the government bill is published, the Bundesrat will have the opportunity to comment on the draft bill. This is followed by the decisions of the Bundestag and the Bundesrat. The legislative process is not expected to be complete until the second half of the year.

Measures against Tax Havens – New Countries and a First Birthday

The Act Combating Tax Avoidance and Unfair Tax Competition (Tax Haven Defence Act; THDA) celebrated its first birthday on 1 January 2023, at least based on its period of validity. It governs measures against business relationships with non-cooperative tax jurisdictions. Classification as non-cooperative tax jurisdiction has effects not just on the Tax Haven Defence Act but also on the reporting requirement for cross-border tax arrangements ("DAC 6") and the planned public country-by-country reporting ("public CbCR").

I. Non-cooperative tax jurisdictions

The EU Council assesses countries' tax policy according to transparency, tax fairness, implementation of anti-BEPS measures and information exchange. Those not complying end up on a "black list" of non-cooperative tax jurisdictions. The EU first published the black list in December 2017. The list is updated twice each year, in February and October, with the most recent update being 14 February 2023. Russia was a new addition to the black list along with the British Virgin Islands, Costa Rica and the Marshall Islands.

II. The Tax Haven Defence Act

1. Background

The EU black list does not apply immediately for purposes of the German Tax Haven Defence Act. A tax jurisdiction must first be included in a national regulation before the defensive measures related to that jurisdiction become applicable. At present (March 2023), twelve non-cooperative tax jurisdictions are listed in this regulation ("listed countries"): American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands and Vanuatu. It can be assumed that the countries included in the EU black list in February will soon be listed in the German regulation, i.e. likely in 2023, and will thus fall under the scope of application of the Tax Haven Defence Act.

2. Typical areas of application and sectors

Those affected are domestic taxpayers who have business relationships or investment/ownership relationships with persons in a listed country. The economic reasons for this are irrelevant. With a view to the countries currently listed in the regulation, it is especially (but not only) tourism, aviation and shipping companies that are affected. Following Russia's inclusion in the list, association with a specific business sector will likely become a lesser factor in determining who is affected by the regulation.

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3. The defensive measures

a) "Inbound" cases

The Tax Haven Defence Act provides for withholding tax measures (Section 10 THDA) or a prohibition on deducting business-related and income-related expenses for expenses arising from business relationships in or related to a non-cooperative tax jurisdiction (Section 8 THDA). For purposes of withholding tax measures, the foreign person is assumed to have limited tax liability while the domestic taxpayer is assumed liable for deduction of withholding tax. The limited tax liability of the person, association of persons or pool of assets resident in the listed country covers income from financing arrangements, insurance or reinsurance benefits, trade in goods or services and – since 1 January 2023 – income from the granting or sale of rights that are entered in a domestic public book or register ("register cases").

b) "Outbound" cases

Tighter CFC rules (Section 9 THDA) have been introduced for investments *in* a company in a listed country and cash flows *from* a listed country, while privileges and DTA exemptions for dividends and capital gains (Section 11 THDA) have been abolished.

Following the tighter CFC rules, a foreign entity with all of its income, which is subject to low taxation overall, shall be deemed a controlled foreign company (CFC), irrespective of the activity of income, whether it satisfies the motive test or the exemption threshold for mixed income.

4. Time of application of defensive measures

If a tax jurisdiction is added to the national regulation, the defensive measures and enhanced cooperation obligations related to that tax jurisdiction shall generally apply from the beginning of the following year (or financial year). A "step model" is set out for the time of application for specific defensive measures: the prohibition on deducting business and income-related expenses (Section 8 THDA) applies only from the beginning of the fourth year (or financial year) following a country's inclusion in the regulation, while the measures for dividends and sale of shares/ownership interests (Section 11 THDA) apply only from the beginning of the third year (or financial year) following inclusion in the list.

Example for Russia:

2023: Included in the regulation (assumption)

From 2024: tighter CFC rules (Section 9 THDA), withholding tax measures (Section 10 THDA), enhanced cooperation obligations (Section 12 THDA)

From 2026: Measures for dividends and sale of shares/ownership interests (Section 11 THDA)

From 2027: Prohibition on deducting business expenses and income-related expenses (Section 8 THDA)

III. Further (tax) measures in relation to non-cooperative tax jurisdictions

1. Reporting requirement for cross-border tax arrangements (DAC 6)

Cross-border tax arrangements are reportable in Germany only if a hallmark is satisfied. Such a hallmark relates to specific cross-border payments between two or more affiliated entities if the payment recipient is resident in a tax jurisdiction included on the list of third countries that are classified by the EU Member States or the OECD as non-cooperative jurisdictions. In contrast to the THDA, this provision refers directly to the EU black list, which becomes valid upon being published in the EU Official Journal. Therefore, it is not necessary for the listed countries to be included in a national "German" list.

Russia was placed on the BMF's DAC6 List of States as at 21 February 2023 together with the other new black list states. This makes it the relevant date for the hallmark.

2. Public country-by-country reporting

For the implementation of Directive (EU) 2021/2101, the German federal government on 7 December 2022 issued a draft law as regards the disclosure of income tax information by certain undertakings and branches (public CbCR). It essentially affects standalone undertakings resident in Germany and ultimate parent undertakings with global revenue or consolidated revenue of more than EUR 750 million in each of two consecutive financial years. The disclosures in the public CbCR are to be made separately for each EU/EEA Member State. For third countries, however, disclosure is presented on an aggregated basis unless the third country is e.g., on the EU black list in the reporting period on 1 March. In such cases, the disclosures are also to be made separately. The legislative process is not yet complete. Public CbCR also refers directly to the EU black list, meaning that there is again no need for the country to be included in a national "German" list.

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BFH (I R 53/19): Third-party Appeals not permitted for Notices of Assessment on the Tax-specific Capital Contribution Account

In its ruling dated 21 December 2022, the German Federal Tax Court (BFH) decided that the shareholder of a corporation is not entitled to challenge the notice of assessment issued against the corporation concerning the separate assessment of the amount of the tax-specific capital contribution account.

The German Corporation Tax Act [KStG] states that the amount of the tax-specific capital contribution account is to be established by a separate assessment. In particular, the contributions that the shareholder has made to "its" corporation are to be recorded in the account. If such contributions are later repaid to the owner from the capital contribution account, the shareholder is not required to pay tax on these "repaid contributions". Consequently, although the assessment is mainly relevant for the taxation of the shareholder, the assessment is addressed exclusively to the corporation.

In the case under dispute, the claimant, a foreign corporation, held interests in a German GmbH. In 2007, the claimant paid a high contribution amount into the account. This was – incorrectly – not declared to the tax office as the part of the tax return, and the relevant assessment became final and conclusive. It was only in 2018 that the claimant appealed, arguing that without the contribution being recorded in the tax return, a tax-free repayment of contributions at a later date would not be possible. Neither this appeal nor the subsequent proceedings were successful. The lower tax court ruled that only the GmbH, as the assessment's addressee, is entitled to appeal against that assessment.

The Federal Tax Court (BFH) upheld this view. An assessment can, in principle, be challenged only by its addressees. For the notice of assessment at issue, that means the corporation; therefore, only the corporation can appeal against the assessment and instigate legal proceedings. The shareholder of the corporation is not the addressee but rather a third party; therefore, he is only indirectly affected by the assessment. According to the court, a separate right of appeal ("third party right of appeal") cannot be recognised. The reasoning was that, first, there is no gap in legal protection, as the corporation can claim against errors in the assessment in appeal proceedings; and second, such a right would have the consequence that the decision could still be challenged by the shareholder after many years and thus there would be no lasting legal peace.

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