KPMG

German Tax Monthly

Information on the latest tax developments in Germany

May | 2024

Ministerial Draft Bill for an Annual Tax Act 2024

The business associations have received an (unofficial) ministerial draft bill for an Annual Tax Act 2024. The ministerial draft bill has not yet been published by the Federal Ministry of Finance (BMF). According to reports, the current draft has been submitted by the BMF for early coordination within the government (consultations between the Chancellery, Ministry of Economic Affairs and Ministry of Finance on the draft bill).

The draft bill contains a large number of thematically unrelated or only partially related individual measures in various areas of tax law, which would be predominantly technical in nature. The most important measures are summarised below in bullet points:

1. Restructuring and reorganisations

Book value transfer of assets in connection with partnerships (Section 6 (5) Income Tax Act)

Transfers between "sister partnerships": Preferential transfer of assets at book value even in the case of a transfer without consideration between different partnerships of the same, identically participating shareholders (so-called "sister partnerships"). Retroactive application of the new regulation is provided for in all open cases (due to a requirement of the Federal Constitutional Court). At the joint request of the shareholders, the new regulation is not to be applied for transfers before 12 January 2024, i.e. recognition of the fair market value and not the book value for the transfer.

Corporation tax clause (blocking clause for profit-neutral transfer if a corporation acquires an interest in the transferred asset): Recognition of the fair market value instead of the book value for generally favorable transfers of assets also in the event that the share of a corporation in the transferred asset replaces a direct or indirect share of another corporation, so-called subject-related change of status. Application in all open cases.

Reorganisations

Deferred taxation of hidden reserves in case of exit taxation (so-called balancing item method of Section 4g Income Tax Act): Extension of the scope of application to cases in which a reorganisation results in the realisation of hidden reserves as a result of the restriction or exclusion of the taxing rights of the Federal Republic of Germany (exit taxation). The taxation of hidden reserves is deferred by creating a balancing item to be released over five years. The new regulation is to be applied in all open cases.

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Closing balance sheet of the transferring entity: Introduction of a deadline for submitting the closing tax balance sheet within 14 months of the transfer date for tax purposes. The new submission deadline is to apply in all cases in which the application for entry in the register was made after the date of promulgation of the law.

Taxation of the shareholders of the transferring corporation: Reversal of the valuation rule for mergers for the exchange of shares at shareholder level (shares in the acquiring corporation instead of shares in the transferring corporation). Recognising the book value of the shares in the transferring corporation is the new rule. Recognition at fair market value will only take place at the request of the taxpayer or if the material requirements for the book value approach are not met. The new regulations are to be applied to reorganisations whose tax transfer date is after the date on which the law is promulgated.

Trade tax liability for a gain arising from the sale or the discontinuation of a partnership following a conversion to a partnership even if the shares in the acquiring partnership are only sold indirectly (i.e. in the case of a sale via an intermediary partnership). The rule serves to avoid tax structuring options. First-time application to reorganisations whose tax transfer date is after the date of **publication of the ministerial draft bill**.

Withdrawals from a partnership in the tax retroactive period in case of contributions to a corporation: Valuation of the contributed business assets taking into account the withdrawals from and contributions in the transferred partnership in the tax retroactive period to avoid negative acquisition costs, i.e. hidden reserves may be realised if the transferred business assets would otherwise become negative due to withdrawals in the tax retroactive period. First-time application to contributions if the conversion resolution or the contribution agreement was made or concluded after 31 December 2023.

Retroactive taxation of "contribution gain II" in case of an exchange of shares: After an exchange of shares (contribution of shares to another corporation in return for shares in the acquiring corporation) with a valuation below the fair market value, retroactive taxation, i.e. realisation of hidden reserves at that time ("contribution gain II") may occur if the shares contributed are sold within seven years (harmful event) after the exchange. However, if the received shares in the acquiring company are sold first before the harmful event, the retroactive taxation of the contribution gain II is waived (exception). The 2024 tax act provides for a "clarifying" legal amendment, according to which this exemption from retroactive taxation of the contribution gain II only applies if the sale of the received shares in the acquiring company (or sale-like circumstances such as conversions and contributions) takes place with the realisation of hidden reserves; entry into force on the day after the promulgation of the law.

Tax-specific capital contribution surplus account:

- In reorganisations, no **initial assessment** of the amount of the tax-specific capital contribution surplus account for the acquiring corporation if this is newly created by the reorganisation, i.e. the transferring amount of the tax-specific capital surplus contribution account is deemed to be an addition in the current financial year; entry into force on the day after promulgation.
- **Cross-border reorganisations:** Replacement of the separate assessment procedure for the amount of contributions not paid into the nominal capital at the transferring (foreign) corporation, for which no tax-specific capital contribution surplus account was previously to be assessed, by determining the transferred amount of contributions as part of the determination of the amount of the tax-specific capital contribution surplus account of the domestic acquiring corporation and treatment as an addition in the current financial year; entry into force on the day after promulgation.

2. International taxation

Trade tax in the case of CFC rules: Passive income from foreign permanent establishments is also subject to German CFC taxation (Section 20 (2) Foreign Transactions Tax Act). In addition to corporation tax, CFC income is also subject to trade tax. The 2024 tax act provides for a "clarification" that all passive foreign permanent establishment income is deemed to have been generated in a domestic permanent establishment and therefore also such income for which Germany is already entitled to taxation under the agreement in the case of a Double Taxation Treaty; application in all open cases.

Minimum Tax Act: Implementation of the administrative guidelines adopted by the Inclusive Framework on BEPS on 13 July 2023 for the administration of the GloBE model regulations with regard to mobile employees (consideration of wage costs in one tax jurisdiction), i.e. no pro rata consideration of employees who carry out more than 50 percent of their work in one tax jurisdiction; entry into force with effect from 28 December 2023.

3. Procedural law

FATCA reporting obligations: Increase in the maximum fine for violations of the reporting obligations under the FATCA-USA Implementation Regulation to EUR 30,000; authorisation to regulate the provisions on fines for violations by reporting financial institutions within the framework of a statutory ordinance; entry into force on the day after promulgation.

Financial Account Information Exchange: New offence of fines in the event of a breach by financial institutions of their obligation to prepare records on the application and fulfilment of the due diligence and reporting obligations under the Financial Account Information Exchange Act and specification of the record-keeping obligations. Applicable from 1 January 2025 and only for obligations relating to reporting periods beginning on or after 1 January 2025.

4. Further measures

Tax exemption for photovoltaic systems: increase in the permissible gross output from 15 kW to 30 kW (peak) per residential or commercial unit; entry into force on the day after promulgation.

Real estate transfer tax: New regulation on the attribution of real estate to the assets of a company for so-called “share deal” cases (transfer of shares in corporations or partnerships that own real estate – supplementary cases pursuant to Section 1 (2a) to (3a) Real Estate Transfer Tax Act (RETTA); attribution to the assets of the company that last realised an acquisition of real estate according to the basic cases (e.g. through a purchase agreement) pursuant to Section 1 (1) RETTA. The realisation of a real estate acquisition through a share deal pursuant to Section 1 (3) or (3a) RETTA should no longer lead to a change in the ownership (for RETT purposes) of the property. Entry into force on the day after promulgation.

5. Outlook

The proposed legislation is at a very early stage. Following publication of the ministerial draft bill by the BMF, the Federal Government must approve the draft. This will be followed by the parliamentary procedure in the Bundestag and Bundesrat. Significant changes may still arise in the further course of the legislative process.

The Act should generally enter into force on the day after promulgation. The special regulations on the entry into force of the individual articles and the temporal application of the individual laws must be observed.

In this context, it should be noted that individual, more stringent measures are to be applied retroactively, especially in case of reorganizations and restructurings.

BFH (IV R 26/21): Transfer of the Trade Tax Loss Carryforward to a Partnership

In its judgment of 1 February 2024 (IV R 26/21), the Federal Tax Court (BFH) ruled that, following a transfer of the entire business of a corporation to a partnership in accordance with Section 24 of the Reorganization Tax Law [UmwStG], the trade tax loss carryforward previously generated by the corporation can be utilized at the level of the absorbing partnership, provided that the activity of the corporation is now limited to the management of the interest in the absorbing partnership and the holding of the interest in the general partner GmbH.

For an entity subject to trade tax in Germany, the utilization of a trade tax loss carryforward in accordance with Section 10a of the Trade Tax Law [GewStG] requires both corporate identity and entrepreneurial identity according to the case law of the BFH. The term "corporate identity" means that the commercial business existing in the year of the loss utilization must be identical to the commercial business that existed in the year in which the loss was incurred. The criterion of entrepreneurial identity additionally requires that the entrepreneur has suffered the loss in his own person.

In the case in dispute, a US LLC (deemed as corporation for German tax purposes) maintained a permanent establishment in Germany, for which a trade tax loss carryforward (trade loss) was determined as at 31 December 2010. With effect from 1 October 2011, the LLC transferred the entire assets and liabilities of the permanent establishment, including the intangible and off-balance sheet assets, to a GmbH & Co. KG, which also took over all existing contractual and employment relationships of the permanent establishment. The transfer was made in accordance with Section 24 UmwStG. After the transfer, the GmbH & Co. KG continued the business in its entirety. In addition to being a limited partner and holding the interest in the general partner GmbH, the LLC no longer carried out any other commercial activities in Germany. The tax office took the view that the trade loss incurred in the permanent establishment could not be utilized by the GmbH & Co. KG after the transfer.

The complaint was successful. The BFH ruled that the requirements of corporate identity and entrepreneurial identity were met in the case in dispute and, consequently, the trade loss previously generated by the LLC could be offset against the trade income of

the absorbing GmbH & Co. KG. In its reasoning, the BFH firstly stated that the UmwStG (here Section 24) does not regulate a transfer of the trade loss to the absorbing partnership, but does not exclude it either. However, a transfer of the trade loss was to be affirmed due to the presence of corporate identity, as the commercial business transferred to the GmbH & Co. KG was identical to the business in which the losses were incurred and the LLC's activities in Germany after the transfer were limited to the administration of its interest in the GmbH & Co. KG (so-called "total spin-off"). The fact that the corporation continued to exist after the transfer and was (still) deemed to be a commercial business in accordance with the fiction of Section 2 para. 2 sentence 1 GewStG did not prevent the loss transfer. This is because, in the opinion of the BFH, in the case of a total spin-off, the fiction of commerciality steps back behind the actual and identity-preserving continuation of the commercial business by the partnership.

In this respect, the present case is to be distinguished from the case in which a corporation transfers its operating business to a partnership, but does not limit its activities after the transfer to the administration of its interest in the partnership, but also holds shares in subsidiary corporations. In this constellation, the BFH is of the opinion that there is no total spin-off, with the result that the trade loss of the corporation is not transferred to the partnership (BFH ruling from 17 January 2019, III R 35/17).

Lower Tax Court of Münster (2 K 842/19 F): German CFC Rules in Case of a Holding Company

The old version of the German CFC rules applies where foreign companies are controlled by German resident taxpayers and generate so-called passive income which are subject to a low rate of taxation (controlled foreign company - CFC). If the foreign company carries out several activities, each activity must be examined separately with regard to the existence of passive income (so-called segmented approach). The activities are only assessed together if they are functionally related (so-called functional approach). Interest income generally qualifies as passive income. Where the CFC rules apply, the income of the CFC is attributed to the shareholder and is thus subject to German taxation. In the case of EU/EEA companies, the application of the CFC rules despite the existence of passive income may be avoided if evidence can be provided that the controlled subsidiary pursues a genuine and actual business activity in the Member State in which it was established (“motive test”).

In its judgement of 6 February 2024, the Lower Tax Court of Münster comments on whether

- a foreign holding company generates passive income
- and, if so, can apply the motive test.

In the years in dispute, 2011 to 2016, a Belgian and low-taxed company was controlled by taxpayers resident in Germany. It acted as a holding and management company and held several investments in German and foreign companies. It mainly generated income from lending within and outside the group (interest income) and the provision of consultancy services. In the years prior to 2011, it also generated income from the sale of investments. In the years in dispute, it maintained a rented office space, had its own telephone and fax lines as well as e-mail addresses and office equipment. The business was managed by four members of the board of directors. It was disputed whether the interest income earned qualified as passive income and, if so, whether the motive test could be applied.

The Lower Tax Court of Münster is of the opinion that the functional approach applies in the present case. It must be assumed that the holding activities of the Belgian company are to be assessed uniformly. This is because there is a close economic connection between its various activities (holding investments, lending activities, sales activities, and consulting activities). However, this (summarized) holding activity is not covered by the “active catalogue” in the law. The interest income therefore also qualifies as passive in the present case.

However, according to the Lower Tax Court of Münster, the motive test can be successfully applied. What is required is

- a stable and continuous participation in the economic life of another Member State (participation in general economic transactions)
- and the actual exercise of an economic activity by means of a fixed establishment in the other Member State for an indefinite period of time.

In the years in dispute, the Belgian company continuously and sustainably participated in economic life in Belgium in its capacity as a holding and management company, had appropriately qualified staff and suitable business premises and thus sufficient economic "substance" and generated its income from its own (holding) activities.

The appeal to the BFH was not allowed. It should also be noted that there has been a new version of the German CFC Rules since

2022. According to this, the motive test now requires a substantial economic activity.

Application Regulation on Increased Duties to cooperate under the Act to Combat Tax Havens

On 21 February 2024, the Federal Ministry of Finance (BMF) published a so-called non-objection regulation to Section 12 of the Act to Combat Tax Havens (StAbwG).

Section 12 StAbwG stipulates an increased duty of co-operation on the part of the taxpayer. Accordingly, records must be kept of certain business transactions in or relating to a non-cooperative tax jurisdiction. These records must be transmitted to the locally competent tax authority and, in certain cases, also to the Federal Central Tax Office (BZSt). The transmission must generally take place within a period of one year after the end of the respective calendar year or financial year.

According to the BMF guidance that has now been published, the application of Section 12 StAbwG means that for financial years that began before 31 December 2022, no objections will be raised if the records are submitted for the first time by 31 May 2024.

Imprint

Published by

KPMG AG
Wirtschaftsprüfungsgesellschaft
THE SQUAIRE / Am Flughafen
60549 Frankfurt

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