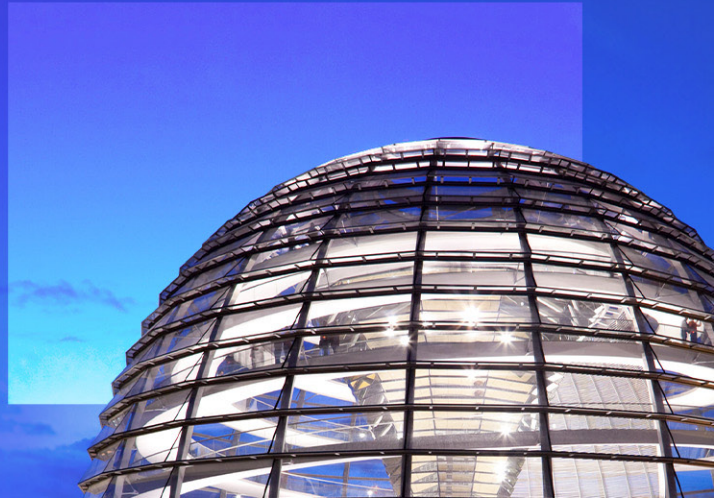


# German Tax Monthly

Information on the latest tax developments  
in Germany

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## Government Draft for a Tax Development Act

The Federal Ministry of Finance has published the government draft for an Act on the Further Development of Tax Law and the Adjustment of the Income Tax Rate (Tax Development Act). The draft bill is intended to implement the first measures from the federal government's growth initiative as well as plans from the coalition agreement of the governing parties. The most important measures are summarised below:

### 1. Investment incentives

As the first steps in implementing the federal government's growth initiative, the Tax Development Act provides for various measures to incentivise investment. Among other things, it is planned to improve depreciation possibilities and extend the existing research allowance.

### Collective depreciation

Under current law, there are two options for simplified depreciation for assets with low acquisition/production costs: Assets with costs of up to EUR 800 can be depreciated immediately. Alternatively, assets with costs of more than EUR 250 and up to EUR 1,000 can be combined in a so-called collective item. The collective item is to be dissolved over a period of five years. If the taxpayer opts for

the collective item, all assets purchased or produced in a year that are within the value limits must be included in the collective item (so-called exclusivity requirement). In this case, they cannot be depreciated immediately.

With regard to the depreciation option for collective items, both the lower amount limit (of EUR 250) and the upper amount limit (of EUR 1,000) are to be raised to EUR 800 respectively EUR 5,000. In addition, the reversal period for collective items is to be reduced from five years to three years.

With the increase in the lower amount limit of the collective item, taxpayers will in future also have the option of immediately depreciating assets with acquisition or production costs of up to EUR 800 in accordance with the regulation for low-value assets. The exclusivity requirement between the regulation for low-value assets and the collective item method is to be abolished and thus, according to the explanatory memorandum to the law, both methods are to merge and complement each other in future.

The amendment to the law is to be applied for the first time to assets that are acquired or manufactured after 31 December 2024.

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## Declining balance depreciation

For movable fixed assets acquired after 31 December 2024 and before 1 January 2029, the declining balance method of depreciation is to be continued for a limited period. In addition, the depreciation rate is to be increased again to 2.5 times the straight-line depreciation rate, up to a maximum of 25%.

Currently, declining balance depreciation applies to assets that were or will be purchased or manufactured after 31 December 2019 and before 1 January 2023 (2.5 times the straight-line depreciation rate, max. 25%) or after 31 March 2024 and before 1 January 2025 (2 times the straight-line depreciation rate, max. 20%).

## Expansion of research allowance

The maximum assessment basis for the research allowance is to be increased from the current EUR 10 million to EUR 12 million for eligible expenses incurred after 31 December 2024. The maximum research allowance can therefore increase from EUR 2.5 million to EUR 3 million respectively from EUR 3.5 million to EUR 4.2 million for small and medium-sized enterprises (SMEs).

### 2. *Obligation to notify domestic tax arrangements*

With the Tax Development Act, an obligation to report certain domestic tax arrangements is to be introduced. This implements a plan from the coalition agreement of the governing parties. The regulations are closely based on the already existing notification obligation for cross-border tax arrangements (DAC6).

However, the relevant arrangements (so-called hallmarks) as well as the group of "users" are to be limited.

The so-called intermediaries are to be obliged to report domestic tax arrangements. If an intermediary is subject to a statutory duty of confidentiality, the duty to report certain user-related data is transferred to the user, unless the user has released the intermediary from the duty of confidentiality.

With regard to the relevant cut-off date for the first-time application, the Federal Ministry of Finance is to be authorised to determine the start of the new notification obligation by means of an announcement. The start date is to be determined at least one year in advance. The latest date is expected to be 31 December 2028 (four years after the end of the calendar year in which the Tax Development Act is promulgated).

### 3. *Outlook*

Among other things, the Act is intended to implement the first measures from the German government's growth initiative presented at the beginning of July 2024. The growth initiative also contains numerous other tax-related measures that are not yet included in the current Act.

Individual measures of the current Act (such as the improved depreciation conditions, the extension of the research allowance and the obligation to notify domestic tax arrangements) were already included in the original draft for the Growth Opportunities Act of summer 2023, but were then cancelled by the Mediation Committee for budgetary reasons and due to excessive bureaucracy. Against this backdrop, it remains to be seen which measures of the Tax Development Act will ultimately be implemented.

The government draft can now be introduced into the parliamentary process. The next step in the legislative process will be the Bun-

desrat's statement on the government draft. Significant changes may still arise in the further course of the legislative process.

The Act is generally to 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.

### MLI Application Act Promulgated in the Federal Law Gazette

The "Law on the Application of the Multilateral Convention of 24 November 2016 and Further Measures" (**MLI Application Act**) was promulgated in the Federal Law Gazette on 21 June 2024. The legislative process has thus been concluded.

The Act sets out the modifications to the German tax treaties covered by the Multilateral Convention of 24 November 2016 to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS Multilateral Instrument - MLI). Furthermore, the application and priority of the BEPS-MLI regulations with regard to the respective treaty are concretized.

### 1. *Background and aim of the law*

Due to the large number of options and reservations provided for in the BEPS-MLI, Germany had reserved the right to ensure that the modifications to the German DTTs covered only take effect after the conclusion of domestic measures. This Act is intended to implement these domestic measures. In particular, this Act is intended to specify the modifications resulting from the BEPS-MLI, considering the selection decisions of Germany and the respective other contracting state (so-called matching) for the DTTs

covered. The modifications resulting from this Act will apply in addition to the existing DTTs.

Once the legislative process has been completed, Germany can inform the OECD as MLI depository and the other contracting states of the completion of the domestic measures.

## 2. Scope of application

The selection decisions and declarations of reservation for a contracting state of the BEPS-MLI only become binding once this state has ratified the BEPS-MLI. For this reason, this Application Act only lists the modifications to those tax treaties covered by the BEPS-MLI for which the other contracting state has already ratified the BEPS-MLI. The MLI Application Act therefore extends to the DTTs with the following states:

1. Croatia
2. Czech Republic
3. France
4. Greece
5. Hungary
6. Japan
7. Malta
8. Slovakia
9. Spain

In addition, only those DTTs that have not already been adapted through bilateral agreements are covered by this law. Therefore, the modifications to the DTTs with Austria and Luxembourg - whose adaptation to the MLI was already initiated resp. realised in 2023 - are not covered by this law.

The DTTs with Italy and Turkey covered by the BEPS-MLI are not yet included in this law, as these contracting states have not yet ratified the BEPS-MLI. As soon as this happens, the corresponding modifications are to be supplemented by amending acts.

The DTT with Romania covered by Germany is not modified by the

BEPS-MLI, as Romania has not named the treaty between Germany and Romania in the context of the ratification.

## 3. Temporal application

In principle, the law came into force on 22 June 2024.

As a result of the reservation made by Germany, the BEPS-MLI will take effect for withholding tax on amounts paid or credited to non-residents as follows:

- On or after 1 January of the calendar year beginning 30 days after receipt by the depository of Germany's notification of the completion of the domestic procedures for the BEPS-MLI to take effect in relation to the relevant treaty.

As a result of the selection decision made by Germany and the reservation, the BEPS-MLI will take effect as follows for all other taxes levied for assessment periods:

- On or after 1 January of the calendar year beginning six months after receipt by the depository of Germany's notification of the completion of the domestic procedures for the entry into force of the BEPS-MLI in relation to the relevant treaty.
- However, according to the explanatory memorandum, the six-month period can also be shortened if Germany and the respective contracting state notify the depository that they intend to apply a correspondingly shorter period. The date on which the legal changes resulting from the application of the BEPS-MLI in relation to the respective treaty take effect will be announced in the Federal Law Gazette.

According to this – when using a shorter time period of e. g. two

months – initial application would be possible from 2025 if the depository is notified by the end of September 2024 (30 September 2024 + 30 days = end of October 2024 + 2 months = end of December 2024). According to reports, a shortening of the time period for individual states is already being examined.

## 4. Outlook

In view of the diverse selection decisions and declarations of reservation, the legal practitioner is faced with the challenge of reading the tax treaties adapted to the MLI in the "correct" version in each case. Before this law was referred to the Finance Committee of the Bundestag, the BMF submitted a report containing so-called application aids on the DTTs covered by the BEPS-MLI. These working aids contain synopses of the DTTs covered in their respective modifications by the BEPS-MLI, prepared in accordance with the OECD's guidance. The BMF plans to publish these working aids on its website after this law comes into force.

## Draft Law to Amend the Minimum Tax Act

The Federal Ministry of Finance has published a discussion draft for a law to amend the Minimum Tax Act and other measures.

The aim of the draft law is to implement new OECD administrative guidelines of 15 December 2023, which focus on the CbCR Safe Harbour. In addition, there was a need for further adjustments to the Minimum Tax Act. This is mainly of an editorial nature.

The OECD's Administrative Guidelines of December 2023 contain important specifications and simplifications for the tax administrations and business groups concerned and must therefore be

implemented in a legally binding manner.

In particular, the draft law implements the regulations on the use of so-called report packages, the permissibility of the use of the acquisition method and a provision to prevent unjustified use of the CbCR Safe Harbour. A significant change concerns the inclusion of deferred taxes in the full calculation that are not shown in the minimum annual tax surplus or minimum annual tax deficit due to an option or due to offsetting.

The law is to come into force the day after its promulgation.

The associations can comment on the draft until 6 September 2024.

### **Draft BMF Guidance dated 14 August 2024: Intra-Group Financing**

With the Growth Opportunities Act, which came into force on 28 March 2024, new legal regulations for arm's length comparisons in financing transactions between related parties were implemented in the Foreign Transactions Tax Act (FTTA) (Section 1 (3d) and (3e) FTTA). The new legislation is effective from 1 January 2024.

On 14 August 2024, the Federal Ministry of Finance (BMF) published a draft for the revision of the administrative regulations on transfer pricing principles. The draft deals in particular with the new legal regulations.

The legal principles on arm's length analyses in connection with intra-group financing were extended to include provisions on the deductibility of interest expenses and the classification of routine financial services.

Section 1 (3d) FTTA: Interest expenses of a domestic taxpayer

arising from a cross-border financial transaction are generally only tax deductible:

1. if the domestic taxpayer demonstrates that he could have provided the debt service from the issue/renewal date ("Debt Capacity Analysis") and that the financing is commercially necessary as well as used for the purpose of the business ("Business Purpose Test"); and
2. to the extent the applied interest rate is equal or below the interest rate that would be granted by an external third party based on the group credit rating. If it is proven in individual cases that a rating derived from the corporate group rating ("Credit Rating Analysis") corresponds to the arm's length principle, this must be taken into account when calculating the interest rate ("Interest Rate Analysis").

Section 1 (3e) FTTA: The new law classifies a pure brokerage service or forwarding of a financing transaction as well as typical treasury functions (such as liquidity management) or activities as financing company as a low-function and low-risk service (which is to be rewarded with a routine compensation). An exemption for a non-routine compensation is possible if the taxpayer evidences a more complex profile for the financial service providing company based on a functional and risk analysis (which would conversely allow a non-routine reward).

Key statements from the draft BMF guidance summarized:

#### *Temporal application*

The provisions on interest deduction (Section 1 (3d) FTTA) do not apply to expenses based on financing relationships that were agreed under civil law before 1

January 2024 and the actual implementation of which began before 1 January 2024. This does not apply if the continuing obligation is substantially amended after 31 December 2023 or continued beyond 31 December 2024.

#### *Financing relationship in principle*

The essential criteria for determining whether and to what extent a relevant financing relationship exists are the expected debtor's ability to service the capital (in particular in the form of interest payments and repayment) and the serious agreement to provide capital for a limited period of time. In particular, it is important to determine whether sufficient assets or cash flows can be expected from the outset to satisfy the lender (debt capacity analysis). Other indicators include the existence of a fixed repayment date, the obligation and modalities for the payment of interest, the right to enforce the principal and interest payment, and the ability of the beneficiary of the funds to obtain loans from independent third parties under comparable conditions. This does not rule out the arm's length nature of particularly risky financing relationships, which are customary in the market for start-up financing, for example.

The financing must also have been economically needed. An orderly and conscientious manager will not borrow capital on the market unless there is at least a reasonable prospect of a return that covers the financing costs.

The use of debt capital must also be in line with the company's purpose (business purpose test). An investment in the call money account or a deposit in an intra-group cash pool, especially if no higher return is expected, is generally incompatible with the company's core business. In principle, taking out a loan for the purpose



of distributing profits does not contradict the company's purpose.

The taxpayer must credibly demonstrate that the requirements (debt capacity analysis and business purpose test) are met. Accordingly, the taxpayer must show (1) whether and how the capital service can be provided (e.g. on the basis of a forecast calculation, which may also include follow-up financing), (2) that the capital service will be provided as agreed, and (3) what purpose the capital provided is and how the capital will be used.

If the taxpayer cannot credibly demonstrate that the requirements are met, the financing relationship does not comply with the arm's length principle. The reduction in domestic income caused by the financing relationship is to be reversed in the amount of the non-arm's length portion.

#### *Arm's length interest rate*

In principle, the creditworthiness of the group of companies is decisive, unless the creditworthiness of the borrower in question is better. In principle, the interest rate to be determined is therefore based on the creditworthiness of the entire group of companies. The rating of the group of companies is primarily based on the financial statements of the group of companies and the planning for the group. Only if the taxpayer can prove that a rating derived from the group rating complies with the arm's length principle can it be used to determine the interest rate. For the creditworthiness assessment, the functional and risk profile of the borrower must also be taken into account. The result of the analysis is the determination of whether and to what extent the company is strategically important for the group of companies. This has a corresponding effect on the rating of the specific company.

#### *Financing relationships as a low-function and low-risk service*

The determination of an arm's length price for the provision of debt capital between related parties is generally based on the price comparison method. If a group's financing company that does not have the ability and authority to control the risk of this financing transaction or to bear it is intermediated, it is only entitled to a risk-free return as remuneration for the brokerage, the transfer or transfer of the capital and the associated low-function and low-risk service. Consequently, if the extension of the loan and the actual control of the functions or risks associated with it are different, there is a further transaction between the financing company and the company exercising effective control of the functions or risks associated with the provision of the loan.

Financing functions usually represent support functions for the value-adding core business. The situation is different if the financing function is a primary function and thus a core component of the value creation model, such as in the banking or insurance sector.

There is an opportunity to comment on the draft until 6 September 2024. This could be followed by the publication of the final BMF guidance by the end of the year.

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