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Ministerial Draft Bill for a Second Future Financing Act

The Federal Ministry of Finance has published a ministerial draft bill for a second act to finance future-proof investments (Second Future Financing Act).

According to the explanatory memorandum, stable and efficient capital markets are of crucial importance for innovation, private investment and growth. With the (first) Future Financing Act, numerous measures have already been taken to improve the framework conditions for the capital market and start-ups. The aim of this draft bill - building on the (first) Future Financing Act - is to further strengthen the competitiveness and attractiveness of Germany as a financial location and, in particular, to improve the financing options for young, dynamic companies. This includes, in particular, the tax framework, which is an important factor for investment decisions.

Among other things, the draft law serves to implement the growth initiative adopted by the Federal Cabinet on 17 July 2024. A further aim of the draft bill is to make capital funds available to a greater extent for investments in infrastructure and renewable energies. Regulations, particularly in financial market law, company law and tax law, are to be further developed with this objective in mind.

In the area of tax law, the draft provides for amendments to the Investment Tax Act and, in particular, adjustments to the taxation of profits from the sale of shareholdings in corporations if these are reinvested ("roll-over"). Here, the maximum amount for the transfer of hidden reserves from the sale of shares in corporations to reinvestments is to be increased from EUR 500,000 to EUR 5,000,000. The amendment is to apply to capital gains from financial years beginning after the promulgation of the Act.

Federal Tax Court (VIII R 9/23): Constitutionality of the Interest Rate in the Event of Suspension of Enforcement

With its order for reference dated 8 May 2024, the court is seeking a ruling from the Federal Constitutional Court on whether the interest rate for the suspension of enforcement from 1 January 2019 to 15 April 2021 is compatible with constitutional law insofar as the calculation is based on an interest rate of 0.5% per month.

In the case in dispute, the plaintiff filed an administrative appeal and subsequent legal action against his 2012 income tax assessment. At the plaintiff's request, the tax office suspended the enforcement of the income tax assessment from the due date. The action was ultimately unsuccessful. The tax

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office assessed interest with suspension of enforcement for the period from 22 September 2014 to 15 April 2021 at an interest rate of 0.5% for a total of 78 full months. The plaintiff filed an administrative appeal against the interest assessment within the deadline and subsequently filed an action, which was dismissed by the lower tax court in first instance.

In its current order for reference, the Federal Tax Court does not agree with the constitutional assessment of the lower court. It is convinced of the unconstitutionality of the amount of interest in the event of suspension of enforcement since 1 January 2019.

The Federal Tax Court states that, in principle, administrative appeals and legal actions do not have a suspensive effect in German tax law. However, taxpayers have the option of having the suspensive effect ordered separately by means of a suspension of enforcement upon application if there are serious doubts about the legality of the contested assessment. On the one hand, this means that taxpayers do not initially have to pay the tax. On the other hand, they are threatened with interest if their appeal is ultimately unsuccessful, and they have to pay the tax "retrospectively". According to the current legal situation, taxpayers must then pay interest of 0.5% per month, i.e. 6% per year, on the amount of the suspended tax for the duration of the suspension of enforcement.

In its decision of 8 July 2021, the Federal Constitutional Court declared the so-called full interest rate at this level from 1 January 2014 to be incompatible with the principle of equality but did not extend this to interest for the suspension of enforcement and other interest. A separate constitutional assessment was necessary in each case.

In the opinion of the Federal Tax Court, an interest rate of 0.5% per month, i.e. 6% per year in the period from 1 January 2019 to 15 April 2021, is incompatible with the principle of equality. At least during a sustained period of structurally low interest rates, the statutory interest rate is clearly not (or no longer) necessary to absorb the liquidity advantage typically achievable through a later payment. In addition, there is also unequal treatment between taxpayers who owe interest because they have not paid the tax after suspension of enforcement and taxpayers who must pay interest on arrears because their tax assessment has resulted in a difference (and they therefore have to pay the tax owed from the outset only at a later date). Since 1 January 2019, interest on arrears has only been calculated at an interest rate of 0.15% for each month, i.e. 1.8% per year. According to the Federal Tax Court, this deviation in interest rates is also not justified under constitutional law.

Federal Tax Court (I R 2/21): Tax Consequences of a US Economic Embargo for a German Group Company

If a German group company has incurred expenses due to a US embargo and waives the agreement of a claim for reimbursement or compensation against its US group parent company, this can lead to the granting of an advantage and thus to a fictitious profit distribution by the German group company to the US group parent company. This was decided by the Federal Tax Court in a ruling of 22 May 2024.

The plaintiff is a German limited company (German Co.) and part of a group with a parent company (US Co.) domiciled in the USA, which indirectly holds a 100% stake in German Co. German Co. concluded business contracts with a customer based in Venezuela between 2004 and 2006. In 2007, the US imposed an economic embargo on Venezuela. US companies were no longer allowed to supply customers in Venezuela. For this reason, the management of the US Co. instructed German Co. not to continue executing the contracts. Therefore, the Venezuelan customer sued the German Co. in Venezuela for damages. In an international arbitration, it was finally agreed that German Co. would pay damages, claims for unjust enrichment and proportionate procedural costs. German Co. claimed these payments as expenses for tax purposes.

The tax office treated the expense as a fictitious profit distribution by German Co. to US Co. (shift of advantage caused by the shareholder relationship), because the contract cancellation had been carried out solely in the interest of US Co. The fictitious profit distribution has the tax consequences that German Co. cannot deduct the expense for tax purposes and withholding tax on the fictitious profit distribution must be paid to the tax office. The US Co. is only entitled to a refund of the withholding tax under certain conditions and taking into account the DTT Germany/USA.

In its ruling, the Federal Tax Court confirms that a shift of benefits in favor of US Co., which is treated as a fictitious profit distribution for tax purposes, could in principle exist. The decisive question is whether the actions of the German Co. are caused or co-initiated by the corporate relationship with the US Co. In the present case, there may have been a saving in expenditure on the part of US Co. because German Co. bore the expenses. The fact that German Co. did not claim reimbursement or compensation for the expenses against the US Co. can result in a prevented increase in assets for German Co.

However, the Court was unable to conclusively decide the case due to a lack of information on the facts. The lower tax court must now make up for this information. However, the Federal Tax Court provides guidance on the legal assessment.

If the US Co. had caused the German Co. to breach the contracts by issuing an instruction without providing an arm's length consideration, the US Co. would have saved expenses in this respect. A prudent and conscientious managing director would comply with a concluded contract if he were not forced to break it due to external circumstances (e.g. legal prohibition) or to prevent major damage threatened by the execution of the contract (ex ante). Otherwise, a non-shareholder would have been able to induce such a managing director to breach the contract only if he had made a binding commitment to assume the associated risk of damage and to provide appropriate compensation for the loss of profit.

In particular, the lower court has to make findings on the content of the US embargo. This is because the breach of contract would not have been caused by the shareholder relationship if a corresponding obligation on the part of German Co. had already resulted from the embargo. In addition, the lower court has to determine whether US Co. had caused German Co.'s breach of contract by the instruction given. In this context, the breach of contract would not be caused by the shareholder relationship if a managing director acting in an orderly and conscientious manner had decided to breach the contract even without corresponding instructions due to possible (detrimental) economic consequences in the event of a continuation of the contract.

The present case deals with a period of about 20 years in the past. However, the principles of the judgment still apply today and must be observed in the case of current international sanctions and economic embargoes.

Federal Tax Court (III R 30/21): Business Identity for Corporations for the Purpose of Loss Utilisation

In its ruling of 25 April 2024, the Federal Tax Court commented on the question of the extent to which the continuation of a trade loss determined at the end of the previous year for a corporation remains dependent on the criterion of so-called “business identity”. A special feature is that the corporation had received the trade loss from a partnership by way of universal succession through accrual with the transfer of all assets and liabilities without liquidation.

Corporations and commercially active partnerships are generally subject to trade tax in Germany. The taxable basis for trade tax is the profit from business operations (so-called trade income). Unused trade losses are determined separately and can be carried forward, i.e. they can be offset against profits in subsequent years.

Under German civil law, a partnership must consist of at least two partners. If, for example, a partnership has two corporations as partners and one is merged into the other, its assets, including its trade losses, are transferred to the last partner and it ceases to exist (so-called accrual). However, the use of the trade loss by the absorbing corporation requires, among other things, the business identity. This is the case if the business operation existing in the loss deduction year is identical to the one that existed in the year in which the loss was incurred. This is to be assessed according to the overall picture, in particular according to the type of activity, the customer and supplier base and the workforce.

In the case of corporations, however, it should be noted that, unlike in the case of partnerships, their activities are always and, in their entirety, regarded as business operations. The criterion of business identity therefore has no significance - at least in principle - for the continuation of the trade loss in the case of a corporation. Until now, however, it has been disputed whether something different applies in exceptional cases if a corporation takes over a trade loss from a partnership by way of accrual. The question arises as to whether the absorbing corporation must continue the business of the partnership that it has accrued until the loss has been fully utilised.

In the case in dispute, the plaintiff (corporation) sold the business taken over from a partnership to another corporation by way of an asset deal approximately two years after the accrual. From then on, it only acted as a holding company.

According to the court, the asset deal is not detrimental to the continued use of trade losses. These are not lost. No exception is to be made to the principle of irrelevance of business identity in the case of a corporation, even following an accrual.

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