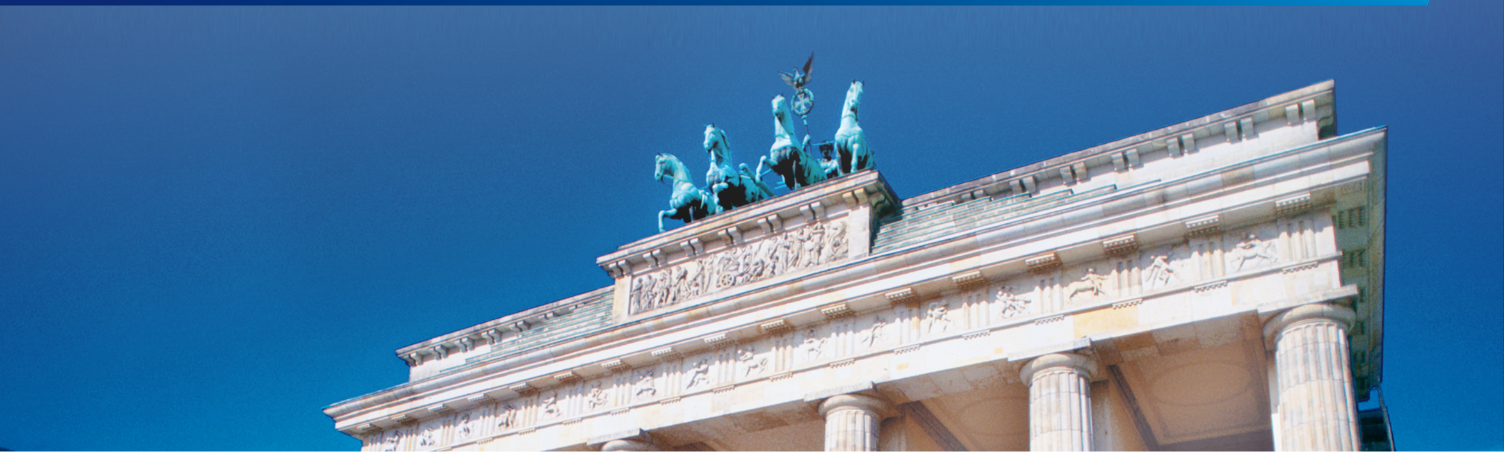
cutting through complexity

German Tax Monthly

January/February 2015



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1. Proclamation of the Customs Code Alignment Law ("2015 Tax Act")

The Law regarding the Alignment of the General Tax Code to the European Customs Code and the amendment of other rules and regulations (Customs Code Alignment Law) was promulgated in the Federal Law Gazette on 30 December 2014. Hence, the legislative procedure is finalized. The extent of the proposed amendments shows that this law constitutes the de facto "2015 Tax Act".

Most important contents of the Customs Code Alignment Law:

Extension of the denial of partial deduction (§ 3c (2) EStG – Income Tax Law)

The scope of application of the so-called denial of partial deduction within the meaning of § 3c (2) EStG is extended to decreases in business property or business expenses in connection with shareholder loans or securities to a corporation. Lenders who directly or indirectly hold or held 25% of the shares are affected. Arm's length loan conditions or provisions of securities are excluded.

In addition, the denial of partial deduction is applicable to

- claims from legal actions that are economically comparable to the grant of a loan and
- a transfer of assets motivated by the shareholder relationship to a corporation in which the resident taxpayer holds more than 25% without or for partial consideration. According to the explanatory memorandum to the law, this particularly applies to cases where assets are transferred in the context of a business split-up.

The revisions are applicable for the first time to business years beginning after 31 December 2014.

Rewording of the definition of "business relationship" within the meaning of § 1 AStG

Pursuant to § 1 (4) sent. 1 no. 1 AStG – Foreign Transactions Tax Law-Draft, the definition of business relationships within the meaning of the principles of transfer pricing of § 1 AStG is amended in accordance with the Guidance issued by the Ministry of Finance (BMF) on 4 June 2014. According to § 1 (4) sent. 1 no. 1 let. b AStG, the term "business relationship" does not refer to a relationship that is based on an agreement pursuant to articles of incorporation, partnership or association.

Content

Responsible
Dr. Martin Lenz
mlenz@kpmg.com

Published by
KPMG AG Wirtschaftsprüfungsgesellschaft
The Squaire, Am Flughafen
60459 Frankfurt/Main, Germany

Editorial Team
Prof. Dr. Gerrit Adrian
Alexander Hahn
Corinna Landua
Christian Selzer
Corinna Tigges

The Customs Code Alignment Act now provides for a definition of the term “agreement pursuant to articles of incorporation, partnership or association”. Following this definition, such agreement shall directly result in a legal change of the shareholder status. The revisions are applicable for the first time to the assessment period 2015.

Benefits to employees at company events

The introduction of § 19 (1) sent. 1 no. 1a EStG is meant to react to the current Federal Court of Justice (BFH) case-law, which is in part contrary to the previous administrative practice regarding the tax treatment of company events, regulated by the Wage Tax Guidelines. Benefits of employers to their employees and their accompanying persons on the occasion of social events on a corporate level (company events) are classified now as income from dependent work. Each employee is granted a tax-exempt amount of € 110 per company event. This tax-exempt amount, however, can only be claimable for up to two events per year. The revision enters into force on 1 January 2015 and are not, as requested by the Bundesrat (upper house of the German parliament), applicable to all open cases.

Others

- Tax exemption of so-called “INVEST-grants” for venture capital
- Procedural reliefs with regard to the collection and use of the tax identification number
- Value Added Tax Law: Introduction of a quick reaction mechanism in order to extend the reverse charge procedure and extension of the regulation regarding the place of supply of a service laid down in § 3a (4) sent. 2 no. 6 let. a UStG – VAT Law to other banking and financial services insofar as these are transacted by a bank or are to be regarded as financial turnovers such as, for example, securities asset management.

Outlook

Even though numerous proposals submitted by the Bundesrat have not been adopted in the Customs Code Alignment Law, according to a minutes statement by the Federal Government, however, specific concerns expressed by the Bundesrat shall be reviewed by the Federal Government in 2015. This especially should apply to an adjustment of the Reorganization Tax Law, hybrid mismatch arrangements and the tax treatment to gains derived from the disposal of portfolio investments. For further information about the Bundesrat’s proposals please refer to the December 2014 edition of German Tax Monthly, p. 1.

2. Law Amending the Tax Procedure Law and the Law Introducing the Tax Procedure Law

The Law Amending the Tax Procedure Law was promulgated in the Federal Law Gazette on 30 December 2014. The law entered into force with effect from 1 January 2015.

It is the objective of the law to resolutely combat tax evasion by significantly tightening the rules regarding voluntary disclosure with exemption from punishment and refraining from criminal prosecution in particular cases.

A person who furnishes the tax authorities or other authorities with incorrect or incomplete particulars concerning matters of substantial significance for taxation or who fails to inform the tax authorities of facts of substantial significance for taxation when obliged to do so and as a result understates taxes or derives unwarranted tax advantages commits tax evasion. The person must have acted willfully (i.e. with intent and in the awareness of doing wrong). Already an attempt of tax evasion is punishable.

In cases of effective voluntary disclosure of tax evasion, exemption from punishment may be granted provided the tax evaded is paid in due time including interest and surcharges, where applicable.

Main amendments:

Extension of the time allowed for correction

According to the law as previously in force, voluntary disclosure only exempted from punishment if all tax offences relating to a specific type of tax that had not become time-barred under criminal law were fully corrected. The statute of limitations for tax evasion under criminal law is ten years in particularly serious cases and five years in all other cases. However, the statute of limitations for the assessment of tax is ten years in all cases of tax evasion.

From 1 January 2015 onwards, voluntary disclosure only exempts from punishment if all tax offences relating to a specific type of tax that have not become time-barred under criminal law are fully corrected, and at least all those tax offences relating to a specific type of tax committed within the last ten calendar years preceding the voluntary disclosure.

Advance VAT return and payroll tax notifications

Corrected or late advance VAT returns or payroll tax notifications are treated as an effective partial voluntary disclosure again since 1 January 2015. The exemption from punishment applies to the extent that incorrect particulars are corrected or omitted particulars furnished subsequently. In the case of subsequent furnishing of previously omitted particulars or a correction, detection of the offence shall not preclude the exemption from punishment. The annual VAT return for the previous year does not necessarily have to include the correction of advance tax returns of following periods.

Adjustment and amendments to the reasons precluding the exempting effect of voluntary disclosure

Exemption from punishment is precluded if in the case of a tax offence that has not become time-barred and that was voluntarily disclosed, the offender has been notified of a tax audit order or the initiation of criminal proceedings or proceedings for an administrative fine before the correction, supplementation or subsequent furnishing of omitted particulars. Since 1 January 2015, this effect also relates to instigators and accomplices. Therefore, it will no longer be possible for instigators and accomplices in the future to voluntarily disclose tax offences in order to be granted exemption from punishment once offenders or beneficiaries have been notified of a tax audit order.

The preclusive effect of a notification of a tax audit order or of the arrival of a tax auditor for a field tax audit is restricted to the subject matter and time period to which the (notified) field audit relates. A voluntary disclosure with exemption from punishment remains possible, on principle, for time periods not covered by the (notified) tax audit order.

A VAT or payroll tax review has been included as a new reason precluding voluntary disclosure with exemption from punishment. A voluntary disclosure with exemption from punishment is not possible where a public official of the tax authorities has already arrived on site for the purpose of carrying out a VAT or payroll tax review under applicable tax provisions and has identified himself for this purpose.

Since 1 January 2015 a voluntary disclosure with exemption from punishment is only possible if the unwarranted tax advantage derived has not exceeded € 25,000 (formerly € 50,000) per offence. Another new preclusive reason now also relates to particularly serious cases of tax evasion. Acts of tax evasion are deemed to be particularly serious, for example, where the offender has repeatedly understated tax or derived unwarranted tax advantages using counterfeited or falsified invoices/receipts. In both cases, the offender will not be prosecuted if he pays the taxes, interest and surcharges within the reasonable period of time allowed to him.

Refraining from prosecution in particular cases

The surcharge, which used to be 5 % of the amount of tax evaded, has been increased significantly and, in future, the percentage rises depending on the amount of tax evaded.

Surcharge	**Amount of tax evaded**
10%	≤ 100,000 €
15%	> 100,000 €; ≤ 1,000,000 €
20%	> 1,000,000 €

There is no reimbursement of the surcharge when criminal proceedings move forward, however when the court imposes a fine, the surcharge paid may be offset against the fine.

The resumption of proceedings that were already concluded is allowed when the tax authorities find that the offender has furnished them with incomplete or incorrect particulars.

Payment of interest on evaded taxes and on back taxes

Since 1 January 2015, it is required for an exemption from punishment following voluntary disclosure to not only pay the tax evaded but to also pay the interest on evaded taxes and on back taxes (to the extent that they are credited to the interest on evaded taxes) in due time. In the case of advance VAT returns (except for the annual VAT return) and payroll tax notifications, exemption from punishment arises regardless of the timely payment of the interest. The non-assessment of a fine in cases of reckless understatement of tax is not conditioned on the timely payment of the interest, either.

Statute of limitations for the assessment of tax for undeclared capital income

The statute of limitations for the assessment of tax on undeclared foreign capital income from states which are not EU/EFTA members and from where capital income is not automatically notified to Germany, has been extended significantly. The limitation period begins no earlier than upon the end of the calendar year in which the capital income has been brought to the knowledge of the tax authorities either by declaration of the taxpayer or otherwise, but no later than ten years after the end of the calendar year in which the tax arose. The extension of the statute of limitations for the assessment of tax applies to all assessment periods beginning after 31 December 2014.

3. German Federal Constitutional Court declares inheritance tax law partly unconstitutional

The German inheritance tax law grants a deduction of 85% on the taxable value of the transferred assets for the transfer of so-called privileged business assets. When special requirements are met, this deduction can increase to 100%. The prerequisite here is that the operational assets at the time of transfer do not consist of more than 50%, or 10% of "non-operational" assets. As a further condition, the successors are required to continue to operate the company for five or seven years, may not withdraw any substantial capital from the company and may not significantly reduce all employee wages during this period. This workplace commitment does not apply for companies with 20 or less employees.

In the judgment announced on 17 December 2014, the German Federal Constitutional Court declared the exemption regulations for operational assets in regard to inheritance tax and gift tax law (§§ 13a, 13b ErbStG – Inheritance Tax Law) unconstitutional. According to the Court, the current law leads to an unconstitutional privileged status regarding operational assets, which subsequently results in the submitted regulation being overall incompatible with the constitution due to a breach of the principles of equality (Art. 3 GG).

It is, however, within the legislator's scope of decision-making to grant tax concessions to small and medium-sized businesses, which are under personal management, to secure their existence and to safeguard employment. Nevertheless corresponding regulations must be structured in a significantly more targeted manner than provided for in the currently valid version of the law.

The currently valid provisions are, however, still applicable for the time being. The legislator must introduce a revision by 30 June 2016. The Court pointed out, that under certain conditions the legislator could put a revision in force retroactively to the 17 December 2014 or at a later date. In this case, the transfer of business assets would no longer be privileged pursuant to the old law already from the appointed date.

In any case, for transfers that have been carried out up to and including 16 December 2014, the previously valid exemption regulations are expected to be applicable, irrespective of whether an inheritance tax or gift tax assessment has been issued.

4. BFH (I R 30/13): Trade Tax Add-back in Cases of Domestic Tax Groups vs. Comparable Cross-Border Cases

In a decision of 17 September 2014 the Federal Tax Court (BFH) ruled that it does not constitute a breach of the EU freedom of establishment if interest expenses are added back for trade tax purposes at the level of a German parent owing interest to its Belgian subsidiary.

In the case at issue, the plaintiff, a German parent corporation, received a loan from its Belgian subsidiary. The interest paid by the plaintiff was subject to trade tax add-back rules at the level of the plaintiff while the interest income was subject to tax in Belgium. The plaintiff and its Belgian subsidiary did not form a tax group for trade tax purposes, because, according to the law applicable in the years under dispute, 1999-2001, a foreign corporation could not be a controlled company in a tax group unless it operated a permanent establishment in Germany. This did not apply in the case at hand. Otherwise, all other requirements for forming a tax group would have been met.

The plaintiff argued that due to the trade tax add-back a breach of the freedom of establishment under EU law has occurred, because there would have been no trade tax add-back at the level of the plaintiff if the plaintiff had been able, as controlling entity, to form a tax group for trade tax purposes with its Belgian subsidiary corporation as controlled entity. The plaintiff argued that the fact that the law does not allow cross-border tax groups for trade tax purposes led to unjustified unequal treatment compared with a purely domestic case.

If there is a tax group for trade tax purposes in a purely domestic case, the trade income of the controlled company and the trade income of the controlling entity are determined separately in a first step. Following this, the two income amounts are added up at the level of the controlling entity, because the controlled company is treated as a permanent establishment of the controlling entity. The total serves as the basis for assessing trade tax for the tax group. On principle, the trade income is the taxable income determined according to Corporate Income Tax Law. Certain expenses, particularly interest expenses, which first reduce taxable income, are added back for trade tax purposes as a matter of principle (so-called trade tax add-back). This increases the tax assessment basis for trade tax. However, according to trade tax guidelines the trade tax add-back does not apply to tax groups to the extent that the add-back would result in a duplication of tax burdens within the tax group.

In a purely domestic case the interest income of the controlled company would be included in the total amount of trade income adding up at the level of the controlling entity. If the interest expenses were added back on top of this at the level of the controlling entity, the tax burden would double. Therefore, trade tax add-back does not apply to that extent at the level of the controlling entity in a tax group.

However, the BFH does not regard the trade tax add-back at the level of the plaintiff as a breach of the EU freedom of establishment. Unlike in a purely domestic case, the domestic parent corporation does not incur the tax liability twice in the case at hand even if a cross-border tax group for trade tax purposes was assumed. If a tax group for trade tax purposes was assumed, the trade income amount determined at the level of the Belgian subsidiary corporation would in fact not be added back to the plaintiff's income, because this would be prevented by the Double Tax Treaty between Germany and Belgium. Therefore, in the final analysis there was no unequal treatment of tax groups for trade tax purposes with a domestic vs. with a foreign subsidiary corporation.

5. Düsseldorf Lower Tax Court (6 K 2018/12 K): 5% Add-Backs on Dividends distributed by a non-resident Subsidiary exempt under a DTT

In its decision of 16 September 2014 the Lower Tax Court of Düsseldorf ruled that dividends paid by a non-resident subsidiary which are covered by a participation exemption privilege under a DTT are also subject to a 5% add-back of non-deductible business expenses.

Pursuant to German tax law, the receipts from a participation in a domestic or foreign corporation are principally disregarded when determining taxable income (§ 8b (1) Corporate Income Tax Law - KStG). However, 5% of the receipts are deemed to be expenses which are not deductible as business expenses (§ 8b (5) KStG).

In the case at issue, A-GmbH resident in Germany held a 100% share in each of its non-resident subsidiaries, from which it received dividends in the year at issue (2008). A-GmbH argued that an add-back of deemed business expenses according to § 8b (5) KStG cannot apply in the case at hand, because the dividends must be exempt under a DTT participation exemption. This tax exemption would ultimately be undermined, if due to the add-back of the non-deductible deemed business expenses there would be an effective taxation in the amount of 5% on the gross dividend.

The Lower Tax Court of Düsseldorf dismissed the case and ruled that dividends which are tax exempt under a DTT are principally subject to a general add-back of 5% pursuant to

§ 8b (5) KStG (for an exception please refer to the chapter on the DTT France in the present edition of German Tax Monthly). The Lower Tax Court opined that the national participation exemption privilege pursuant to § 8b (1) KStG and the international participation exemption privilege pursuant to DTT Law coexist independently. However, the tax exemption under the DTT does no longer matter to the extent that the dividends are exempt already under domestic law. A general add-back of non-deductible business expenses in the amount of 5% may apply despite the tax exemption under the DTT. The Lower Tax Court of Düsseldorf does not consider this to be a breach of Tax Treaty Law, because the DTTs authoritative in the case at issue do not deal with the question of deductibility of business expenses. The national participation exemption privilege was fully granted. From the legal point of view, the initially granted full participation exemption is not affected by the fact that – from the point of view of the ultimate economic effect - the resulting tax exemption is then again reduced by 5% of the foreign dividends. In its ruling, the Lower Tax Court of Düsseldorf emphasizes the legal intention at the root of add-back rules, which is that tax–exempt portions of income should generally correspond to a non-deductibility of business expenses associated with such exempt income. In § 8b (5) KStG the legislator merely fixes the percentage of the business expenses associated with the tax-free dividends at a flat percentage of 5%. According to the Lower Tax Court of Düsseldorf, this does not constitute an inadmissible treaty override, because it does not affect Tax Treaty Law.

The Lower Tax Court of Düsseldorf allowed appeal against the above decision because of the fundamental significance of the legal case and for further development of the law. It is currently not clear, whether A-GmbH has actually filed an appeal. To date, there has been no Supreme Court decision on the compatibility with DTT law of the add-back rules pursuant to § 8b (5) KStG authoritative in the case at issue. However, a decision of the Federal Tax Court (BFH) of 14 January 2009 (I R 47/08) suggested that the BFH's position is that the national exemption pursuant to § 8b KStG in the version of 2002 does not constitute a treaty override over an exemption granted by a DTT. On the contrary, the scope governed by each of the Treaties remains unaffected by the national exemption.

6. Berlin Tax Authority: No 5% Add-Back for Dividends distributed by a non-resident Subsidiary under the DTT France

In a decree dated 29 August 2014 the tax authority of the Federal State of Berlin (Senatsverwaltung für Finanzen Berlin) voiced the legal opinion that an add-back of deemed business expenses in the amount of 5% in the case of an exemption of dividends distributed by a subsidiary under domestic law is not compatible with the participation exemption privilege pursuant to Art. 20 (1b) of the DTT France.

Pursuant to German tax law, the receipts from a participation in a domestic or foreign corporation are principally disregarded when determining taxable income (§ 8b (1) Corporate Income Tax Law - KStG). However, 5% of the receipts are deemed to be expenses which are not deductible as business expenses (§ 8b (5) KStG).

The tax authority holds the view that the DTT France uses special wording concerning the taxation of dividends distributed by a non-resident subsidiary granting tax exemption of the "net income" in the country of residence. Whereas other DTTs in general refer to (income derived from) dividends.

According to the tax authority the amount added back pursuant to § 8b (5) KStG forms part of the provisions on determining taxable income and is therefore covered by the term net income. Consequently, a general add-back of non-deductible business expenses in the amount of 5% for dividends from a French subsidiary is excluded. The tax authority could not detect a potential treaty override in § 8b (5) KStG.

7. Lower Tax Court of Cologne (8 K 731/12): Binding Rulings in one and the same Case

In its judgment of 28 October 2014 the Lower Tax Court of Cologne ruled that in case of multiple applications for a binding ruling in one and the same case a tax authority may only charge the fee once.

In the case at hand, the controlling entity and the plaintiff, the controlled entity, had both filed applications with identical contents requesting a binding ruling in the year at issue (2009), in order to obtain confirmation of the continuation of the tax group relationship in the future.

In Germany, the existence of a tax group for income tax purposes depends on certain conditions. Where these conditions are met, a profit and loss absorption agreement obliges the controlled entity in a tax group to transfer its profit to the controlling entity. If, however, the controlled entity generates losses, the controlling entity is obliged to absorb these losses. The total income is then taxed at the level of the controlling entity, although both the controlled and the controlling entity remain independent legal entities.

If a taxpayer requires a binding ruling regarding the tax treatment in an as yet unrealized matter (e.g. whether the conditions for a tax group for income tax purposes will continue to be met in the future), he may seek that binding ruling from the competent local tax office. A fee is due for a binding ruling, regardless of the outcome of the binding ruling. Since a future recognition of a tax group for income tax purposes affects both the controlled and the controlling entity, each entity has to file an application with identical content requesting a binding ruling from the local tax office.

The plaintiff held the view that the fee is only due once for processing both applications. It argued that, while there were two applications, the tax office only had to decide on one and the same case, i.e. the recognition of a tax group. There can only be an identical answer to this question both at the level of the controlled and at the level of the controlling entity.

The local tax office, however, charged fees in the same amount both from the controlled and the controlling entity. It held that for any single application for a binding ruling a fee is due. This is also true where applications with identical contents are filed. Furthermore, the controlled and the controlling entity remained independent legal entities, despite the fact that they formed a tax group.

The Lower Tax Court of Cologne decided in favor of the plaintiff and argued that in such cases the fee may only be levied once. In cases of tax groups, the fee is always owed only by the controlling entity. Charging the fee twice would in particular be in conflict with the purpose and intent of levying a fee for a binding ruling.

The purpose of charging a fee is to compensate for the work effort of the tax authority (so-called cost compensation function) and for the advantage that the taxpayer obtains based on such a binding ruling (so-called advantage compensation function).

However, the work effort arose only once for the tax authority for both binding rulings, because the identical rulings referred to one and the same case. Nor was charging the fee twice required for reasons of the advantage compensation function, since the binding effect of the binding ruling for the controlling entity alone would have been sufficient to safeguard the interests of all members of the tax group.

Since appeal has been allowed it remains to be seen how the Federal Tax Court (BFH) will decide.

8. Real Estate Transfer Tax

The real estate transfer tax rate levied on real property depends on the Federal State in which the real property is situated. The reason for this is that the Federal States have the right to define the tax rate autonomously.

Two Federal States (North Rhine-Westphalia and Saarland) have increased their tax rates as of the beginning of 2015. The real estate transfer tax rate of Hesse went up by 1.0 percentage point as of 1 August 2014.

Federal States	**As of 1 Jan. 2015**	**Before 1 Jan. 2015**
North Rhine-Westphalia	6.5%	5.0%
Saarland	6.5%	5.5%
Schleswig Holstein	6.5%	
Berlin	6.0%	
Hesse	6.0% (as of 1 August 2014)	
Baden-Württemberg	5.0%	
Brandenburg	5.0%	
Bremen	5.0%	
Lower Saxony	5.0%	
Mecklenburg-Vorpommern	5.0%	
Rhineland Palatinate	5.0%	
Saxony Anhalt	5.0%	
Thuringia	5.0%	
Hamburg	4.5%	
Bavaria	3.5%	
Saxony	3.5%	

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