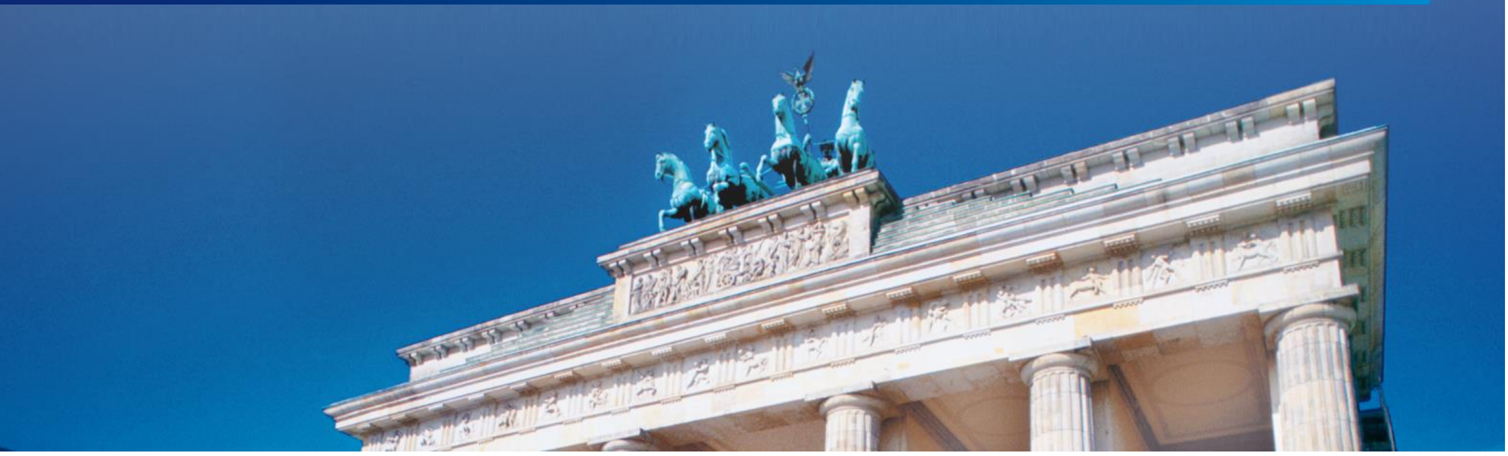
German Tax Monthly
July 2015



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1. Draft General Administrative Guidance on Revised Version of Corporate Income Tax Guidelines 2015

The Federal Ministry of Finance (BMF) issues guidelines for many tax laws commenting on application questions or doubts. The current corporate income tax guidelines (KStR) date back to the year 2004 and are supposed to be up-dated to the most current status. A "Draft general administrative guidance on the revised version of corporate tax guidelines 2015 (KStR 2015)" is available.

Major amendments refer to the following areas:

Third country merger

When companies in third countries merge, the domestic shareholders of these companies are allowed to continue to carry their shares at book value under certain conditions. In the new guidelines the tax authorities have started to interpret the new provision such that a continuation to carry the shares at book value is only possible, where the transferor is subject to limited tax liability in Germany (R 12 KStR 2015-E).

Tax Group

The tax group reform ("kleine Organschaftsreform", see February 2013 edition of German Tax Monthly, p. 2) in 2013 introduced several amendments to the provisions on the taxation of tax groups. The guidelines have now been adapted to the amended legislation. However, unresolved issues in the contents of the amended legislation still remain unresolved to a large extent. One of the amendments of the KStR is connected with the question, when an early termination of a profit and loss absorption agreement is possible. There is an intention to eliminate the previous exception, pursuant to which a termination was possible upon merger, split or liquidation of a controlled entity, even if the early termination of the tax group was already clear when the agreement was concluded.

Another amendment relates to adjustment items for tax groups. These are created, where the profit actually transferred to the controlling entity under commercial law is not congruent with the attributable income according to tax law. Where a shareholding in a controlled company of a tax group ("Organgesellschaft") is subsequently sold, the adjustment item will serve corrective purposes in order to avoid double- or non-taxation of profits. Until now it has been controversial, how to technically implement an adjustment of the gains on such sales. In the new guidelines the tax authorities argue that when a shareholding in a controlled

Content

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company is sold the adjustment item has to be netted with the book value of the shareholding. The technical implementation is, in particular, important for the application of tax-exemptions regarding the disposal of shareholdings.

Outlook

However, there are still no comments in the guidelines concerning crucial parts of the scope of application of the Corporate Income Tax Law [KStG] such as earnings strippings, tax-exemption for dividends and loss of loss carryforwards in case of changes in ownership.

If the guidelines do not provide for anything to the contrary, the new KStR is intended to be applicable starting from the assessment period 2015.

2. CJEU Deems German Exit Tax Rules Compatible with EU Law (C-657/13)

German tax law contains major provisions pertaining to exit taxation which are to ensure that hidden reserves are taxed in cases where Germany’s right to tax the profit derived from an asset's sale or use is precluded or restricted. Exit taxation rules apply, for instance, if a business asset is transferred from a German business to a foreign permanent establishment. Exit taxation, in principle, triggers immediate taxation. However, if the asset transfer takes place within the EU, taxation of the hidden reserves may be spread out over several years on request.

It has remained unclear so far whether German exit taxation rules are compatible with Community law. Following a request for a preliminary ruling by the Lower Tax Court of Düsseldorf dated 5 December 2013 (8 K 3664/11 F, see February 2014 edition of German Tax Monthly) the CJEU ruled in a decision of 21 May 2015 ("Verder LabTec", C-657/13) that the German exit taxation provisions are compatible with the freedom of establishment under Community Law. In the case at issue a partnership resident in Germany transferred patent, trade mark and utility model rights to its permanent establishment in the Netherlands in 2005. At the time of the transfer of the rights, the tax authorities did not immediately tax the hidden reserves, but allowed the creation of a neutralizing “pro memoria item” for equitable reasons to be released in instalments over a period of 10 years thus increasing taxable profit.

The CJEU considers the deferred phased collection of the tax in question over a period of 10 years a proportional measure to protect Germany's justified interests in taxing the hidden reserves accrued on German territory. Basically, the CJEU had ruled similarly on 23 January 2014 ("DMC", C-164/12, see March 2014 edition of German Tax Monthly) when it decided in favor of a recovery of taxes on hidden reserves in instalments spread over five years. Therefore, a deferred phased collection over a period of ten years is inevitably proportional.

The current provisions of § 4g Income Tax Law [EStG] that provide for the creation of a pro memoria item pursuant to § 4(1) sent. 3 EStG as well as the taxable profit-increasing release in installments over a period of five years were not subject of this ruling ("Verder LabTec"). Thanks to the explicit reference in the reasoning for the decision to the five years phased deferral one can also safely assume conformity of § 4g EStG with Community law regarding the phased payment in the present case.

3. BFH (I R 70/13): Shareholder Bound by the Assessment of the Tax-Specific Capital Contribution Account

In a decision of 28 January 2015 the Federal Tax Court (BFH) ruled that the shareholder of a corporation is bound by the assessment of the so-called tax-specific capital contribution account (“steuerliches Einlagekonto”) in the corporation concerning the tax treatment of amounts distributed to it.

Corporations resident in Germany maintain a “tax-specific capital contribution account” (“steuerliches Einlagekonto”) in order to record contributions which have not been made to the share capital. A corporation must submit a declaration each year for the separate assessment of the balance of the tax-specific capital contribution account. Any payment made by the corporation to its shareholders out of the tax-specific contribution account (so-called repayment of a contribution) is generally tax-exempt at the level of the shareholder. However, whether such payment is made out of the tax-specific contribution account or deemed to be a taxable profit distribution is not an arbitrary decision. The so-called appropriation sequence (“Verwendungsreihenfolge”) must be applied. According to this rule, for the payments made by the corporation profits are deemed to be distributed first (taxable profit distribution) before the contribution account may be used. Unlike the tax-exempt repayment of a contribution, a distributed dividend is subject to withholding tax.

In the case at issue (2006) the plaintiff (a German limited liability company [GmbH]) distributed amounts to its two shareholders. The amounts distributed were tax-exempt repayments of contributions, so that no withholding tax was withheld. In the declaration for the separate assessment of the tax-specific capital contribution account as of 31 December 2006 the plaintiff, by mistake, did not record the amounts as repayments from the tax-specific capital contribution account. Correspondingly, the balance of the tax-specific capital contribution account was declared as being the same as in the previous year and assessed such by the local tax office. After the assessment, it was no longer possible for the plaintiff, for legal reasons, to subsequently change the declaration for the separate assessment of the tax-specific capital contribution account as of 31 December 2006.

Since repayments from the tax-specific capital contribution account were assessed as being zero, the local tax office treated the amounts distributed as dividends which are taxable at the level of the shareholder. Consequently the tax office issued an additional assessment notice assessing back taxes with regard to the withholding tax claim.

As opposed to this the plaintiff argued that withholding tax is not due, because the payments were in actual fact tax-exempt repayments of contributions. In the alternative the plaintiff requested the withholding tax to be assessed at zero on equitable grounds, because the declaration for the separate assessment of the tax-specific capital contribution account as of 31 December 2006 was made incorrectly by mistake.

In its ruling of 28 January 2015 the BFH confirmed the view of the local tax office. The amounts distributed were taxable as dividends, so that withholding tax was to be withheld. The BFH argued that the appropriation sequence has to be observed also at the level of the shareholder. In the view of the BFH the shareholder cannot successfully claim that contrary to the assessment of the tax-specific capital contribution account a reduction of the tax-specific capital contribution account had occurred. Because the shareholder is bound by the assessment of the tax-specific capital contribution account even if in actual fact a tax-exempt repayment of a contribution has occurred. Assessing the withholding tax at zero on equitable grounds is not possible in the case at hand, because the plaintiff acted with gross negligence in the exercise of its obligations with regard to withholding tax.

4. Lower Tax Court of Lower Saxony (6 K 424/13): Group of Acquirers with Convergent Interests within the Meaning of § 8c (1) Sent. 3 KStG

In a judgment dated 26 February 2015, the Lower Tax Court of Lower Saxony passed a decision in a case concerning a group of acquirers with convergent interests ("Gruppe von Erwerbern mit gleichgerichteten Interessen") within the meaning of the loss limitation rules of § 8c Corporate Income Tax Law [KStG].

According to the loss limitation rules contained in § 8c (1) sent. 1 KStG, loss carryforwards and losses not utilized by a corporation are forfeited on a pro-rata basis, if within a period of five years more than 25% of, inter alia, the share capital in a corporation is transferred directly or indirectly to an acquirer (detrimental change in ownership). An "acquirer" within the meaning of this provision may also be a group of acquirers with convergent interests. Where more than 50% of the shares are transferred, loss deduction will be completely denied.

In the case at issue a German limited liability company [GmbH] held more than 50% in a loss corporation. The three shareholders of the GmbH sold their shares (1/3 each) to three other GmbHs by two notarized agreements.

According to the view of the tax authorities, the three acquirers are a group of acquirers with convergent interests within the meaning of § 8c KStG, since the three acquirers had acquired their interests upon agreement in two uniform transactions.

The Lower Tax Court of Lower Saxony ruled in the case at issue that the requirements for a group of acquirers with convergent interests are met where several acquirers in the course of and with respect to an acquisition of interests in a loss corporation act concertedly, and where this group is able to exercise concerted control over the loss corporation following the acquisition, for example by a voting rights pooling agreement, by forming a syndicate or by means of other binding arrangements. The decisive date for this is the acquisition date. The acquirers must have made their arrangements with regard to the later common control of the corporation by that point in time at the latest. The pure joint holding of the interest in a loss corporation and the common interest in the economic performance of the corporation does not suffice as convergent interests of a group of acquirers within the meaning of 8c KStG. In the case at issue the Lower Tax Court ruled that the requirements for a group of acquirers with convergent interests were not met.

The tax authorities have appealed against this judgment. Therefore it remains to be seen how the Federal Tax Court (BFH I R 30/15) will decide in this matter.

5. Reorganizations: Lower Tax Court of Hamburg (2 K 66/14) Deems Exit Taxation Rules of Reorganization Tax Law 1995 Incompatible with Community Law

German tax law provides for central provisions on exit taxation. These are to ensure taxation of hidden reserves where the German right to tax the gains arising from the sale of a business asset or the use of such business asset is either precluded or restricted. In its judgement the Lower Tax Court of Hamburg followed the decision of the CJEU of 23 January 2014 (see March 2014 edition of German Tax Monthly) which relates to a provision of the Reorganization Tax Law on exit taxation which was abandoned in 2006. The disputed rules of the Reorganization Tax Law regulated the taxation of the contribution of business assets to a corporation. The law principally provides the possibility of a tax-neutral contribution. However, there was an exception where Germany's right to tax gains on the sales of shares in a corporation granted to the contributor was precluded at the time of the contribution. In this case the hidden reserves contained in the contributed business assets had to be taxed at the time of their contribution. In cases of reorganizations within the EU, upon request the tax payment could be spread over a period of (maximally) five years.

In the case at hand, two corporations resident in Austria contributed their interests in a German limited partnership [KG] to a German limited liability company [GmbH] by way of a contribution in kind against granting company rights. The German KG owned hidden reserves. As a result of the contribution the GmbH held all interests in the KG, meaning that the assets of the KG were transferred to the assets of the GmbH (so-called "Anwachsung" or accrual). The tax office started from the premise that according to the DTT Germany-Austria, Germany had lost the right to tax the shares in the GmbH, to which the interests in the KG were contributed. It opined that the aforementioned preconditions of the Reorganization Tax Law were met and therefore recognized the hidden reserves in the assets of the KG at the time of the contribution. On request it was possible to spread out the corresponding tax payment over a period of (maximally) five years instead of an immediate taxation. In the opinion of the plaintiff the taxation of the hidden reserves constitutes a breach of Community law because it infringes the freedom of establishment, provided in the Treaty on the Functioning of the European Union. If the contributing GmbHs had had their registered offices in Germany, the unrealized gains hidden in the contributed shares would not have been taxed.

The Lower Tax Court of Hamburg had requested a preliminary ruling from the CJEU, and in this ruling dated 23 January 2014 the CJEU decided that the provision infringes the free movement of capital, provided in the Treaty on the Functioning of the European Union. However, the infringement may be justified in order to protect a balanced allocation of the power to impose taxation between the EU Member States. According to the CJEU the decisive question was whether Germany actually loses every right to tax the unrealized gains and this was now the question on which the Lower Tax Court of Hamburg had to decide.

In its judgement of 15 April 2015 (no appeal allowed) the Lower Tax Court of Hamburg ruled that an immediate taxation is incompatible with Community law, since Germany does not entirely lose the right to tax the hidden reserves contained in the contributed KG assets due to the reorganization. The court held that it is sufficient for the German right to taxation to continue to exist that the unrealized gains that formerly belonged to the contributed KG are taken into account in the corporate tax assessment of the receiving GmbH.

6. Lower Tax Court of Münster (9 K 1828/11 K G) on the Abandoned Thin Capitalization Rule: Elective Option when Allocating Several Loans to the So-Called "Safe Haven"

The abandoned thin capitalization rule (old version of § 8a German Corporate Income Tax Law [KStG]) was primarily intended to counteract excessive shareholder loans to a corporation by its foreign shareholders. Where the requirements of this rule were met, the payments by the corporation for debt capital loaned by the shareholders were not recognized as business expenses, but had to be added back to the profit of the corporation within the off-balance-sheet corrections (treatment as "constructive dividend"). The requirements were regularly met where the payments for debt capital exceeded the total amount of € 250,000 per fiscal year, and to the extent that debt capital exceeded 1.5 times the pro-rated equity of the shareholder (so-called "safe haven": debt-equity-ratio < 1.5).

Where a corporation had taken out several loans at different interest rates and where the total amount of the loans exceeded the "safe haven", it has been questionable so far exactly which of the loan amounts were the ones that exceeded the "safe haven". This leads to the related question of which interests have to be added back within the off-balance-sheet corrections. The wording of the law did not provide for an explicit rule. In a guidance of the Federal Ministry of Finance (BMF) of 15 December 1994 the tax authorities published their view that the loans had to be allocated to the "safe haven" in exact chronological order (first in - first out). However, in the case at issue the plaintiff argued that he had an elective option as to the question of which loan amounts to allocate to the "safe haven". This would mean that if there are several loans with different interest rates there is a possibility to allocate the loan amounts with the highest interest rates to the "safe haven".

In its ruling of 29 August 2014 the Lower Tax Court of Münster confirmed the plaintiff's view. In the view of the Lower Tax Court of Münster the disputed provision of the old § 8a KStG is an anti-abuse clause. The assumption of an elective option would not compromise the realization of the legislative intention.

The disputed provision of the old § 8a KStG was last applicable for fiscal years beginning before 26 May 2007. To the extent that the decision of the Lower Tax Court of Münster is confirmed by the Federal Tax Court (BFH) in the appeal procedure (I R 70/14), it might merit attention for assessment periods that are still "open".

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