German Tax Monthly

Information on the latest tax developments in Germany

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Law on the Modernization of Taxation Procedures

On 12 May 2016, the Bundestag (Lower House of the German Parliament) adopted the "Law on the Modernization of Taxation Procedures" (StModG). The StModG is to set the legal framework for the modernization and simplification of procedures particularly with a view to increasing the use of electronic means. In addition, the law includes a modification of the concept of costs of production for income tax purposes. Following is a summary of the most important changes contained in the new law.

Automated processing of tax returns

The StModG is to provide the legal foundation for processing tax returns purely supported by automated means by applying risk management systems. Based on this, the tax authorities may now issue, withdraw, cancel, suspend or modify tax assessments purely supported by automated means. The tax returns are verified with the help of a risk management system.

Filing of tax returns, extensions of time to file tax returns and filing penalties

The general deadline for filing tax returns will be extended from five to seven months. For taxpayers who have engaged a tax advisor for the preparation of their tax return, the statutory extension of the time limit will be extended to the last day of the month of February of the second calendar year following the tax period. However, the tax offices may, under certain circumstances, request an earlier filing of the tax return which has to be complied with within four months (advance request). Further extensions of time limits will no longer be possible in future unless the taxpayer is unable to meet the time limit without any fault on his part. The revision is planned to apply for the first time to tax periods beginning after 31 December 2017.

In future, a filing penalty will have to be imposed where tax returns are not filed within 14 months or within the time limit specified in the advance request.

Content

Apart from a very limited number of exceptions, the tax authority will no longer have any room for discretion in these cases. The revisions regarding the late filing penalty shall apply for the first time to tax returns to be submitted after 31 December 2018.

Electronic notification and electronic retrieval of administrative acts

Subject to the consent of the taxpayer, notices of assessments and other administrative acts may in future be made available for electronic retrieval, and also notification will be effected electronically. Taxpayers (or their authorized agents) will be informed by email that the data are ready for retrieval. The revision is planned to apply for the first time for administrative acts issued after 31 December 2016.

Other amendments

Binding ruling

Where binding rulings affect more than one person, the Federal Ministry of Finance (BMF) will be entitled to determine the requirements under which a binding ruling is to be issued to more than one person in an identical way and which tax authority is competent for providing such binding ruling. This will mainly affect assessments for partnerships or cases involving tax groups. Correspondingly, where identical rulings are issued to several applicants, a fee will only be levied once in future.

Electronic certificate regarding the payment of withholding tax

Certificates regarding the payment of withholding tax on capital income may in future be transmitted only electronically to the creditor of the capital income. However, the creditor continues to be entitled to request a certificate on paper.

Concept of costs of production for tax purposes

The capitalization requirement for tax purposes for administrative overhead costs and expenses for social facilities of companies and company pensions is to be aligned to the capitalization option under commercial law. The prerequisite for this is that the option is actually exercised in accordance with the commercial balance sheet, to the extent that such balance sheet is prepared. Providing this option is in agreement with many years of administrative practice.

Outlook

After its adoption by the Bundestag, the law is pending consent by the Bundesrat (upper house of the German Parliament), which will possibly be granted even before the summer break, as well as the promulgation in the Federal Law Gazette. The law is to enter into force on 1 January 2017.

Draft Bill for the Ratification of the MCAA on the Exchange of Country-by-Country Reports

On 27 January 2016 the Federal Republic of Germany and 30 other states signed the Multilateral Competent Authority Agreement (MCAA) on the Exchange of Country-by-Country (CbC) reports (the "Multilateral Agreement"). The present draft bill, resolved by the Federal Government on 6 May 2016, is intended to ratify the Multilateral Agreement.

The Multilateral Agreement relates back to the final report published on 5 October 2015 on Action 13 of the OECD project against base erosion and profit shifting (BEPS Action 13 "Country-by-Country Reporting Implementation Package"). The final report on Action 13 includes, among others, an international automatic exchange of CbC reports. The intention is to increase international tax transparency and to improve access of the respective competent tax authority to multinational enterprises' information about their worldwide distribution of income and taxes paid.

The Multilateral Agreement obliges Germany to require the ultimate parent companies of big Multinational Enterprise (MNE) groups resident in Germany to annually file CbC reports and to make them available to the other treaty states in which the MNE groups pursue business through group enterprises or permanent establishments. It covers MNE groups with annual revenues of at least € 750 million in the fiscal year directly preceding the reporting fiscal year. In return, the other treaty states undertake to convey to Germany the relevant CbC reports of the ultimate parent companies resident in their territories, to the extent that these contain information about group enterprises or permanent establishments that are subject to tax in Germany.

The Multilateral Agreement contains nine sections which in particular define the terminology decisive for the Agreement such as "Competent Authority", "Multinational Enterprise Group" and provisions regarding time and manner of the exchange of information as well as requirements concerning confidentiality and data safeguards. Germany made a statement on the interpretation of the Multilateral Agreement, according to which in particular any term not defined in the Multilateral Agreement has to be interpreted according to national legal provisions. Finally, Germany made a further statement, according to which any information exchanged is in particular subject to the confidentiality rules of the Convention on Mutual Administrative Assistance in Tax Matters of 27 May 2010.

The draft bill of the Federal Government constitutes an early stage in the legislative process. Both the Bundestag and the Bundesrat (lower and upper house of the German Parliament) have to resolve on the bill. Apart from the ratification of the Multilateral Agreement, a domestic legal provision will have to be in place to commit the ultimate parent companies resident in Germany to file a CbC report. The implementation of such a provision will be part of a further legislative process.

Regional Tax Office Karlsruhe: Treatment of Dividend Payments within Tax Groups

In its administrative guideline dated 17 February 2016 the regional tax office (OFD) Karlsruhe comments on expenses of controlled companies which are directly related to the dividend income (see May 2016 edition of German Tax Monthly for further details).

According to oral information provided by the OFD Karlsruhe, the guideline is currently not applied. The background is that at the moment there are ongoing discussions at the federal level about the treatment of expenses directly related to dividend income that a controlled company receives from substantial shareholdings. An internal instruction within the tax authority advises not to treat such cases until a decision has been reached at the federal level. The discussion only relates to the treatment of expenses. In principle, the decision of the Federal Tax Court (BFH) of 17 December 2014 (I R 39/14) continues to be applicable (see April 2015 edition of German Tax Monthly).

Federal Tax Court (I R 22/14): Permission to use a Name within a Corporate Group does not constitute a Business Relationship under Foreign Transactions Tax Law

Section 1 of the Foreign Transactions Tax Law (AStG) contains an income adjustment provision that applies to cross-border business relationships of related parties. Where intra-group transactions are agreed based on conditions that do not comply with the arm's length principle, an adjustment for tax purposes is possible. Under certain circumstances, there will be a recognition of an adequate consideration at the resident taxpayer. The central prerequisite for the recognition of such an adjustment amount is that a business relationship exists between the taxpayer and the related party.

In its judgment of 21 January 2016 (I R 22/14) the Federal Tax Court (BFH) ruled that granting permission to use a name free of charge between related parties of a corporate group does not constitute a business relationship within the meaning of Sec. 1 AStG previous version and must therefore be recognized for tax law purposes.

In the case at issue the plaintiff who operated commercial business activities in Germany had designed a graphic sign ("company logo") and made it available for use by its Polish subsidiary on the subsidiary's website, letterhead and company cars. In the years under dispute 2004 - 2006 the use of the logo by the Polish subsidiary was free of charge. The dispute was over whether the profit should have been adjusted to increase income according to Sec. 1 AStG previous version, because the permission to use the company logo was granted without consideration.

Pursuant to the BFH decision, the mere use of a name within a corporate group does not give rise to an adjustment when determining profits within the meaning of AStG previous version. As a rule, granting such a permission does not allow for license fees to be recognized as consideration for tax purposes. However, according to the BFH judgment, the situation would be different if a trademark- license agreement was concluded granting the right to use the company name and logo as trademark to be displayed on the products sold or offered for sale. This would allow to establish an inextricable link between the right to use a name and product-related trademark. To the extent that a separate value can be determined, a consideration in line with the arm's length principle may be requested with the diligence of a prudent and conscientious business manager for granting permission to use such trademark. However, in the case at issue the BFH did not see sufficient indication for this.

Lower Tax Court of Düsseldorf (6 K 1947/14 K,G): Valuation of Shares in Cases of Downstream Mergers

In a decision of 22 April 2016 the Lower Tax Court of Düsseldorf ruled that in case of a cross-border downstream merger, shares in a receiving corporate entity may be transferred at book value.

Pursuant to German Reorganization Tax Law, business assets transferred during a merger are, in principle, valued at their fair values. However, upon request they may be recognized at book value, provided that this does in particular neither exclude nor restrict the German right to tax future gains on sale. Furthermore, the law governs how the shares in the receiving corporate entity held by the transferring corporate entity have to be valued. These have to be recognized at least at book value increased by any earlier tax-effective depreciation.

The question is, however, how shares in the receiving corporate entity have to be valued, in case that foreign shareholders hold shares in the transferring corporate entity.

In the case at issue, a German parent company was merged into its (foreign) subsidiary. The shareholder of the parent company was resident in the United States. After the downstream merger the shares of the subsidiary were allocated to this shareholder. Consequently, the right to tax any future gain on the sale of these shares did no longer belong to Germany but to the United States.

Therefore, the local tax office was of the opinion that the shares had to be valued at fair value. The realization of the hidden reserves would consequently result in a 95% tax-exempt profit (§ 8b Corporate Income Tax Law (KStG)).

The Lower Tax Court ruled, however, that the shares in the receiving corporate entity have to be recognized at book value also in the case of a downstream merger where the German right of taxation is not secured. In the opinion of the Court, the Reorganization Tax Law provides for a special and final valuation rule for the valuation of shares in the receiving corporate entity. According to this rule, the generally applicable preconditions for the transferred business assets do not have to be verified, so that the loss of the German right of taxation does not conflict with a valuation at book value. Consequently, no taxable gain is derived from the transfer. Thus, the ruling contrasts with the opinion of the authority as contained in the Reorganization Tax Decree. The Lower Tax Court allowed appeal against the decision.

Lower Tax Court of Münster (9 K 1472/13 G): Trade Tax Add-Back for Travel Companies

In its decision of 4 February 2016, the Lower Tax Court of Münster ruled on the extent to which expenses have to be added back for the purpose of determining trade income in cases of renting individual or blocks of hotel rooms or chartering ships.

German trade tax law provides for several different add-backs to profit when determining trade income. Such add-backs to profit include, among others, parts of rental expenses for movable and immovable fixed assets.

The plaintiff, a German limited liability company (GmbH), is a travel company and

- rented a hotel, paid all the expenses and operated the hotel with its own personnel.
- rented blocks of rooms including ancillary services (use of the hotel pool, sports facilities and sunbeds).
- chartered a ship and offered trips on the same.

The Lower Tax Court of Münster decided that the hotel operated by the plaintiff is a permanent establishment of the plaintiff. Therefore, the rental expenses were incurred at the foreign permanent establishment. Since only domestic permanent establishments are subject to trade tax, the revenues and expenses of the foreign hotel do not form part of trade income, according to the Court. Therefore the expenses cannot be added back.

However, the renting of blocks of hotel rooms including ancillary services may be subject to trade tax add-backs. It may therefore be required to distinguish between the rental expenses attributable to movable versus to immovable assets because of the difference in proportions for add-backs. Pure operating expenses (water, power, heating) and expenses for independent ancillary services that do not constitute leasing or renting activities, such as providing food, transport / shuttle services or spa and sports services, are not added back. This also applies where such ancillary services are not stated separately on the bill.

When chartering a ship, the main contractual service does not consist in renting the ship but in performing a voyage, which is in conflict with the interpretation as rental or lease agreement, according to the Lower Tax Court of Münster. Therefore, a trade tax add-back is precluded.

Appeal to the Federal Tax Court was allowed by the Lower Tax Court of Münster.

Recent Developments regarding German Double Tax Treaties

In the following, we would like to give an overview of the most recent developments regarding the German Double Tax Treaties (DTT).

DTTs that have entered into force

China: The new DTT China dated 28 March 2014 entered into force on 5 April 2016 and will be applicable as from 1 January 2017. See May 2014 edition of German Tax Monthly for content of the new DTT China.

Uzbekistan: The amending protocol to the DTT Uzbekistan entered into force on 29 December 2015 and has been applicable since 1 January 2016. See December 2015 edition of German Tax Monthly for content of the amending protocol.

DTTs that were signed but not yet transposed into German law

Netherlands: On 12 May 2016 the Bundestag (lower house of the German Parliament) passed the law on the amending protocol to the DTT Netherlands, which had been signed on 11 January 2016. The approval of the Bundesrat (upper house of the German Parliament), the promulgation in the Federal Law Gazette and the exchange of the instruments of ratification are still pending. See March 2016 edition of German Tax Monthly for content of the amending protocol.

Japan: On 1 April 2016 the German Government published a draft law on the DTT Japan, which was signed on 17 December 2015. Before the instruments of ratification can be exchanged, the law will have to be passed by the Bundestag and the Bundesrat and will subsequently have to be promulgated in the Federal Law Gazette. See January/February 2016 edition of German Tax Monthly for content of the new DTT Japan.

Australia: On 6 May 2016 the German Government published a draft law on the DTT Australia, which was signed on 12 November 2015. Before the instruments of ratification can be exchanged, the law will have to be passed by the Bundestag and the Bundesrat and will subsequently have to be published in the Federal Law Gazette. See December 2015 edition of German Tax Monthly for content of the new DTT Australia.

Finland: A new DTT between Finland and Germany was signed in Helsinki on 19 February 2016. Upon entry into force the new DTT will replace the current DTT of 5 July 1979.

The most important changes of the new DTT are presented below.

The general withholding tax rate for dividends is 15%. In cases of direct shareholdings of at least 10% the withholding tax rate will be reduced to 5% (Art. 10 (2)). This is a significant improvement over the current DTT which only provided for a reduction of the withholding tax rate to 10% where the shareholding was at least 25%. Pursuant to the new DTT, no more withholding taxes are levied on interest and royalties (Art. 11, 12).

The country where real estate is located has the right to tax gains on the sale of shares in certain real estate companies (Art. 13 (2)).

The 183-days rule for income from employment will in the future be applied to a period of 12 months commencing or ending within a calendar year (Art. 14 (2) lit. a). In the past, the calendar year was the relevant period.

In transfer pricing matters where one Treaty State adjusts the profits for transactions between associated enterprises, the new DTT provides for the corresponding adjustment obligation of the other Treaty State (Art. 9).

Germany generally avoids double taxation by exempting the income that has in fact been taxed in Finland from the assessment basis (exemption method with subject-to-tax clause, Art. 21 (1) lit. a). For certain types of income the DTT provides for the credit method (Art. 21 (1) lit. b): these include but are not limited to gains on the sale of shares in real estate companies; supervisory board or board of directors remunerations; income of artists and athletes; pensions. A new clause was added to the DTT which provides for a switch-over from the exemption to the credit method for passive income as well as for cases of qualification conflicts (Art. 21 (1) lit. c).

Also added were provisions regarding Mutual Agreement and Arbitration Proceedings (Art. 23) as well as regarding the exchange of information (Art. 24).

The new DTT has not yet entered into force. It still requires the transposition into the national laws of both Treaty States and the subsequent exchange of the instruments of ratification in order to become effective. The legislative process for transposing the new DTT Finland into national law in Germany has not yet started. The treaty will enter into force 30 days after the exchange of the instruments of ratification and will be applicable for the first time on January 1 of the calendar year following the year of entry into force (Art. 28).

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