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Information on the latest tax developments in Germany

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Fourth Coronavirus Tax Assistance Act promulgated

On 22 June 2022 the Fourth Coronavirus Tax Assistance Act to implement tax relief measures for coping with the coronavirus crisis was promulgated in the Federal Law Gazette.

Against the backdrop of the ongoing pandemic-related restrictions, the people as well as the economy are to be supported in overcoming the corresponding economic ramifications. The measures are especially intended to support economic recovery, provide additional investment incentives and reduce the burden on employees. The bill includes new measures as well as extension of existing measures from previous legislative procedures.

Key points of the Fourth Coronavirus Tax Assistance Act

Discounting of non-interest-bearing liabilities: The obligation under tax law to discount non-interest bearing liabilities with a remaining term of more than 12 months is abolished. Previously, such liabilities were required to be discounted at an interest rate of 5.5 percent in the tax balance sheet, resulting in a taxable income. Irrespective of whether they are interest-bearing or non-interest bearing, liabilities are to be stated at acquisition/production cost or an equivalent value under the new regulation. As a rule, this is the nominal value (repayment amount). The discounting requirement ceases to apply for the first time for fiscal years ending after 31 December 2022. On application, the amendment can be applied already for earlier fiscal years. As a result, discounting can cease to apply for years that have already been assessed, provided the respective tax assessments are not final and conclusive.

Extension of declining-balance method of depreciation: The option of using the declining-balance method of depreciation for movable fixed assets is extended by one year. Accordingly, assets that are acquired or manufactured also still in 2022 (currently 2020 and 2021) can be depreciated by up to two and a half times the depreciation on a straight-line basis, but 25% at most.

Content

Loss utilisation:

- **Extending the loss carry-back:** The option of recognising loss carry-backs is extended indefinitely from one to two years. Thus, a loss carry-back is possible in both years directly preceding the year in which the loss was incurred. This is to apply for the first time for losses that are incurred in 2022, i.e. loss carry-backs from 2022 to 2021 and 2020.
- **Extending expanded loss offsetting:** The Third Coronavirus Tax Assistance Act raised the maximum amount of the loss carry-back to EUR 10 million and EUR 20 million in the case of joint assessment for 2020 and 2021. These upper limits are now extended to the end of 2023, which means for loss carry-backs from 2023 to 2022 and 2021.

Extending the deadline for tax-privileged (re)investments: The deadlines for tax-privileged (re)investments pursuant to Section 6b of the German Income Tax Act [EStG] and Section 7g EStG are extended by another year (until 2023).

Subsidies granted for compensation for short-time work: The tax exemption for employer's grants to increase short-time allowance is extended by six months until the end of June 2022 (from previously the end of December 2021).

"Carer bonus": Special benefits granted by employers to employees working in specific areas (especially hospitals) in recognition of their special contribution during the coronavirus crisis (so-called carer bonus) are allowed tax-free up to an amount of EUR 4,500 in the period from 18 November 2021 until 31 December 2022.

Extending the filing deadline for tax returns: The bill provides for various extensions of filing deadlines for tax returns from 2020 to 2024.

Wage tax deduction in maritime transport: In order to implement the agreement with the European Commission, the **register reference for merchant vessels** will be expanded from Germany to include EU/EEA countries.

Outlook

With the promulgation in the Federal Law Gazette, the legislative procedure is completed. The Fourth Coronavirus Tax Assistance Act includes the first tax measures from the new German government's coalition agreement: including expansion of loss carry-backs and extension of expanded loss offsetting. The "super depreciation" for climate protection and digital assets, announced in the government's coalition agreement is not included, but “is being elaborated upon” to bring it to fruition.

Tax Relief Act and Energy Price Lump Sum

On 27 May 2022, the Tax Relief Act was promulgated in the Federal Law Gazette. The act also includes a lump sum for energy prices which is to be paid out by employers to their employees in September 2022. The aim of the act is to provide relief to citizens in view of significant price rises, especially in the energy sector.

All those actively employed are entitled to the lump sum for energy costs in the amount of EUR 300. In principle, employees will receive payment of the lump sum for energy costs from their employer in September 2022. As a rule, employers will be compensated for this payment through a deduction from the total amount of payroll tax to be withheld for the payroll tax filing for August 2022.

In addition, the act also provides for an increase in the employee lump sum allowance by EUR 200 to EUR 1,200 and an increase in the basic tax-free allowance by EUR 363 to EUR 10,347 – both measures apply retroactively from 1 January 2022. As a result, these retroactive increases have an impact on payroll tax deductions already made.

In April 2022, the German federal government also adopted a package of measures for companies affected by the consequences of the war in Ukraine as part of a protective shield ("Schutzschild"); this includes an energy price allowance for companies from specific sectors facing high additional costs due to the rise in gas and electricity prices. The precise arrangement and form of application for this has not yet been announced.

Law for the Amendment to the Interest Rate for Back Taxes and Tax Refunds adopted

The German Bundestag adopted a law particularly governing the amendment to interest on back taxes and tax refunds on 23 June 2022.

With its decision of 8 July 2021, the German Federal Constitutional Court ruled that the interest on back taxes and tax refunds of 6% annually (0.5% per month) was unconstitutional for interest calculation periods starting as from 2014. However, application of the 6% interest rate was still permitted for interest periods up to and including 2018; the Constitutional Court declared the rules inapplicable only for interest periods from 2019 onwards. The legislator was asked by the court to prepare by 31 July 2022 an amendment to the full interest rule for interest periods from 1 January 2019. This is now being implemented with the draft law.

Main content of the draft law

The law provides for a retroactive reduction of the interest rate for interest on back taxes and refunds to 0.15% per month (thus 1.8% per year) for interest periods from 1 January 2019.

This interest rate is to be evaluated for appropriateness at least every two years taking into account developments in the base rate; for the first time as of 1 January 2024. Any adjustment of the interest rate shall then only take effect for subsequent calendar years. To avoid overly frequent or minor adjustments to the interest rate, however, the rate is to change only if the base rate applicable as of 1 January of the evaluation year deviates by more than one percentage point from the base rate applicable when the interest rate was last fixed or adjusted.

The amendments will generally be applicable in all cases pending on the day following promulgation of the act. In cases of interest being recalculated retroactively, the comments in the law indicate that the principle of protection of confidence shall apply. Accordingly, if an interest assessment is revoked or amended, the taxpayer must not be disadvantaged by any recognition of the Federal Constitutional Court's having established as invalid a law upon which the previous assessed interest was based.

The law contains no adjustment of other interest rates under procedural law such as interest on deferrals, evasion, or suspension of collection. The Federal Constitutional Court explicitly stated in its decision that the unconstitutionality does not apply to these other interest situations falling under the same interest rate according to the Germany Tax Code, to the detriment of the taxpayer.

Outlook

After the Bundestag's decision, the Bundesrat still has to approve the law. This could take place in the next session on 8 July 2022. In this case, the law could still enter into force in time for 31 July 2022.

BFH (I R 27/19): Timing of application of the new German Anti-Treaty/ Directive Shopping Rule

In its judgment of 11 November 2021, the German Federal Tax Court [BFH] commented on when the new German Anti-Treaty/Directive Shopping Rule (Section 50d (3) of the German Income Tax Act [EStG] new version) is applicable. It also raised doubts as to whether the ECJ judgment on dividends regarding the violation of European law of Section 50d (3) EStG (old version) is transferrable unequivocally to the interest on a convertible bond in the case under dispute.

Certain payments from Germany to other countries are in general subject to withholding tax, irrespective of any existing DTA. The payment recipient in another country can submit an application to have the German withholding tax refunded. However, in order to do so, the recipient must fulfil certain substance requirements in accordance with the German Anti-Treaty/Directive Shopping Rule (Section 50d (3) EStG).

With regard to dividend payments, the ECJ ruled in 2017 and 2018 that Section 50d (3) EStG old version is in violation of European law due to its strict substantive requirements (C-504/16 and C-613/16 as well as C-440/17). Section 50d (3) EStG old version was therefore revised. The revised version took effect on 9 June 2021 and is in principle applicable to all open cases. To avoid any inadmissible retroactive effect in those cases in which the new regulation would leave the taxpayer in a worse position, a procedure for assessing the most favourable tax treatment is intended, insofar as the payment was received prior to the new version entering into force. In these cases, the old version continues to apply.

In the case under dispute, the plaintiff was a limited company (Ltd.) domiciled in Cyprus. In the years in dispute, 2010 and 2011, it generated limited taxable interest on a convertible bond, which was subject to withholding tax in Germany. The plaintiff did not have any substance. However, an associated company of the plaintiff, which was also domiciled in Cyprus, had offices and staff of its own. Moreover, the offices were equipped with the necessary work facilities and communication equipment.

In dispute was whether the refund claim under the Germany-Cyprus DTT was to be denied pursuant to Section 50d (3) EStG old or new version.

The lower court (Lower Tax Court of Cologne) came to the conclusion without any further examination that the refund claim was admissible because the old version violated European law. In this context, it also had to be taken into account that the group of companies to which the plaintiff belonged had a company in its country of domicile, Cyprus, which was free of any doubts about abuse.

The German Federal Tax Court has considerable doubts however as to whether the ECJ judgment on dividends can be applied unequivocally to the interest at issue in the case under dispute. Moreover, a general reference to the economic activity of another group company in the country of domicile of the payment recipient is not sufficient. Instead, it would be advisable to carry out a comprehensive examination of the relevant group affiliation with respect to the organisational, economic, or other relevant characteristics as well as the structures and strategies of this group. Moreover, the Cologne Lower Tax Court did not examine whether the substance requirements pursuant to Section 50d (3) [EStG], as amended, were fulfilled.

The BFH therefore referred the case back to the Lower Tax Court of Cologne. As the trial court, the Cologne Lower Tax Court must now examine whether the substance requirements of the old or new version could actually be fulfilled or not.

Lower Tax Court of Düsseldorf (7 K 905/19 K,G,F): Dual use of losses in a tax group

The Lower Tax Court of Düsseldorf considers the temporal application regulation on the dual consolidated loss (DCL) rule of the German tax group scheme, which was revised in 2013, to be an impermissible genuine retroactive effect.

According to the German DCL rule, negative income of a tax group parent or subsidiary may not be considered if it is (also) considered in a foreign jurisdiction in the taxation of the tax group parent, the tax group subsidiary, or another person.

This rule was introduced in 2013. At the same time, the requirement of the so-called double domestic nexus for controlled entities (subsidiaries) was revoked. It has been sufficient since then that the controlled entity has its management in Germany, while its domicile (registered office) can be in an EU or EEA country. Unlike before, it is no longer necessary for a controlled entity to have its registered office and place of management in Germany (so-called double domestic nexus). Due to the revocation of double domestic nexus for controlled entities, a consequential amendment to the consideration of losses as described above was made at the same time. According to the explanatory memorandum, as a consequence of the discontinuation of double domestic nexus, dual use of losses is now conceivable at the level of the controlled entity, for example because the company is included in group taxation in various countries. According to the explanatory memorandum, this is particularly the case if the negative income of a dual-resident controlled entity is offset against or deducted from positive income of a group parent in the context of taxation in the foreign jurisdiction. The 2013 law required the application of the new DCL rule to all cases still appealable and thus also retroactively for years prior to 2013.

In the case at hand, the non-consideration of a loss in the 2010 dispute year by applying the DCL rule is in dispute. The plaintiff is a German limited liability company (GmbH) domiciled in Germany. The plaintiff's sole shareholder is Company A, domiciled in the US. In the year in dispute, the plaintiff was the controlling entity of the German GmbH B (controlled entity). For US taxation purposes, the plaintiff was treated as a "disregarded entity" ("check-the-box election"). Accordingly, the plaintiff was considered a permanent establishment of its sole shareholder for US tax purposes. Both the positive and negative income of the plaintiff was determined according to US taxation principles and taken into account for the taxation of the sole shareholder in the US. The plaintiff's income was negative in the year in dispute. This also included an attributed negative income of the controlled entity. The loss determined in the US for the plaintiff as a disregarded entity in 2010 was taken into account in the US taxation of the group. As a result, the German tax authorities adjusted the profit for the domestic taxation of the plaintiff within the scope of a tax audit according to the DCL rule by "adding back negative foreign income in the tax group".

The lower tax court considers the appeal against this decision to be well-founded and is of the opinion that the tax office had no right to disregard the plaintiff's negative income. Although the loss is subject to the DCL rule on the merits, the application of the rule to all cases that are still appealable leads to an inadmissible genuine retroactive effect to the detriment of the plaintiff in the case under dispute. Therefore, a constitutional interpretation of this application rule is necessary in the sense that it does not apply in the case under dispute. The lower tax court concluded that the DCL rule does not apply to assessments that are still appealable for periods prior to 2013 of controlled entities that had their registered office and place of management in Germany. They were not recognised as controlled entities for the first time precisely because of the elimination of double domestic nexus requirement. These taxpayers therefore did not benefit from this statutory relief, which had however been cited by the legislator as a reason for the consequential amendment to the consideration of limited losses under the DCL rule.

The appeal to the Federal Tax Court was admitted.

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