

# Current tax information for our clients

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## BMF draft on the application of the Foreign Transactions Tax Act

On 20 July 2023, the Federal Ministry of Finance (BMF) published a draft of a BMF guidance on the principles for the application of the Foreign Transactions Tax Act (FTTA, in particular on CFC taxation (FTTA Application Decree)). The associations will be given the opportunity to comment on this draft by 4 September 2023.

The new application decree is to apply to the versions of the respective provisions of the FTTA applicable from 1 July 2021, taking into account the application provisions of Section 21 FTTA.

In the following, the background of the adjustments is briefly described and initial information on the draft is given with a focus on CFC taxation.

### 1. Background of the adjustments

The new application decree is intended to adapt the existing BMF guidance of 14 May 2004 on the principles for applying the FTTA (IV B 4 - S 1340 - 11/04) to the current legal situation. The Act on the Implementation of the Anti-Tax Avoidance Directive (ATAD Implementation Act of 25 June 2021, Federal Law Gazette I 2021, p. 2035) in particular has resulted in extensive changes to exit taxation

(Section 6 FTTA - transfer of an individual's domicile to a foreign country) and CFC taxation (Sections 7 to 13 FTTA).

The main legal changes in exit taxation were (Section 6 FTTA):

- Reduction of the period of unlimited tax liability from ten to seven years within an observation period of twelve years,
- Relief in the case of only temporary departure, so-called return regulation,
- Unification of the rules on deferment: no differentiation between departures to third countries and EU/EEA countries.

Significant legal changes in CFC taxation (Sections 7 - 13 FTTA):

- Change of the control criterion and introduction of a shareholder-related approach,
- Abolition of the concept of downstream intermediary companies (transferable CFC taxation),
- Revision of the catalogue of active income,
- Revision and extension of the motive test for certain passive income to third countries,

## Content

- 1 Background of the adjustments
- 2 Draft application decree at a glance
- 3 Outlook

## 2. Draft application decree at a glance

### Content and overall scope

With 1,025 marginal numbers on 251 pages, the draft is very comprehensive. The core of the decree are the regulations on CFC taxation with approximately 130 pages and 570 paragraphs. In addition, other topics regulated in the FTTA are addressed, including exit taxation (approx. 38 pages and 127 marginal numbers), the change of residence to low-tax areas, the extended limited inheritance and gift tax liability, family foundations and the taxpayer's duty to cooperate.

The principles for the adjustment of income according to Section 1 FTTA (transfer pricing) are not part of the draft. In this regard, the draft decree refers to the recently updated administrative principles on transfer prices (BMF letter dated 6 June 2023).

### First selected notes on the draft

#### CFC taxation (marginal no. 198 et seqq.):

- **Shareholder-based approach (Section 7 (1) to (3) FTTA):** The draft letter contains detailed explanations on the shareholder-based approach with numerous examples (marginal no. 218 et seqq.).

Pursuant to Section 7 (2) FTTA, control of the foreign company also exists if the taxpayer is directly or indirectly entitled to more than half of the profits or liquidation proceeds of the intermediate company. In the opinion of the BMF, a shareholder position is not required for this. The concrete contractual agreement is decisive, so that hybrid financial instruments (e.g. profit-sharing rights, participating loans or silent partnerships)

can also convey such a claim (marginal no. 276).

- **Closeness through concerted conduct (Section 7 (4) FTTA):** Pursuant to Section 7 (4) sentence 2 FTTA, concerted behaviour between partners of a partnership is rebuttably presumed. In practice, this has considerable consequences, since in principle any participation in a fund in the legal form of a partnership could lead to "control" of any intermediate companies. Proof to the contrary should be possible in particular if the common purpose of the investors is exhausted in an asset situation where the investment object is not concretely determined and as long as investors do not know each other and only have information rights. In this context, blind pool funds are mentioned in particular (marginal no. 301).
- **Relationship to the Investment Tax Law (Section 7 (5) FTTA):** Pursuant to Section 7 (5) FTTA, CFC taxation does not apply if the provisions of the Investment Tax Law are to be applied to the income for which the foreign company is an intermediate company. However, this does not apply if more than one third of the transactions underlying the income is conducted with the taxpayer or persons closely associated with him. The draft contains the statement, which is significant for practice, that the sum of the interim income from transactions with the taxpayer and persons close to him must be taken into account when examining the one-third limit.

Accordingly, the one-third limit is exceeded if the sum of the interim income from transactions with the taxpayer and persons related to him amounts to more than one-

third of the total interim income of the foreign (special) investment fund (marginal no. 313).

- **Active/passive catalogue (Section 8 FTTA):** The draft explicitly clarifies that disposals of assets also belong to the income within the meaning of Section 8 (1) FTTA, insofar as they were used for the activity (marginal no. 325).

According to the BMF, individual activities with a significant economic impact are not to be grouped together but are to be subsumed separately under the catalogue of Section 8 (1) FTTA, even if they have an economic connection with other activities (modification of the previously applicable so-called functional approach with reference to the BFH ruling of 18 December 2019, I R 59/17, BStBl. II 2021, p. 270 in marginal no. 322).

Particularly relevant to practice are the comments on the disputed cases of co-effectiveness in trade and services (Section 8 (1) nos. 4 and 5 FTTA) (marginal no. 352 et seqq.) and on the correspondence rules for profit distributions and transformation cases (Section 8 (1) nos. 7 and 9) (marginal no. 398 et seqq.).

- **Motive test (Section 8 (2) FTTA):** The draft specifies the indeterminate criteria of "substantial economic activity" and "material and personnel resources" regulated in Section 8 (2) FTTA (margin no. 439 et seqq.).

According to the draft, the motive test pursuant to Section 8 (3) FTTA is not to be applied to third-country companies, except in the case of non-controlled investment companies (Section 13 (4) sentence 1

FTTA) (marginal no. 459 and 467, 757).

The motive test is excluded according to Section 8 (2) sentence 5 FTTA, insofar as the essential economic activity is predominantly provided by third parties. This should include, in particular, business management and management contracts (marginal no. 456).

- **Low taxation (Section 8 (5) FTTA):** A foreign company is not taxed at a low rate because its income is taxed by another company within the framework of group taxation (e.g. tax group or consolidation). If a foreign company that belongs to a group of consolidated companies receives passive income, the proportional income tax burden on this income must be determined separately for this company (marginal no. 497). This statement is unchanged compared to the previous application decree.
- **Income of an investment nature (Section 13 FTTA):** Of particular importance for practice is the statement that free float dividends within the meaning of Section 8b (4) Corporate Income Tax Law are income of a capital investment nature (Section 13 (2) FTTA) (marginal no. 742).
- **Procedural obligations (Sections 16 to 18 FTTA):** Pursuant to Section 18 (3) sentence 1 FTTA, each taxpayer with a direct or indirect interest in the foreign company must submit a tax declaration and, if applicable, uniform determination in accordance with an officially prescribed form. In practice, the question often arises as to whether this also applies if the result is that there is no CFC taxation (e.g. because of the

exemption limits in Section 9 or Section 13 (1) sentence 3 FTTA). It is also questionable who is obliged to declare in the case of participation via a partnership. According to the draft decree, there is a duty to declare even if the result is that there is no additional taxation (marginal no. 954). The partnership itself does not have to make a declaration (marginal no. 955).

- **Tightened CFC taxation (Section 9 Tax Haven Defense Act):** For the first time, the draft also contains statements on the tightened CFC taxation (marginal no. 201 et seqq.), according to which not only passive income, but all low-taxed income of an intermediate company is subject to (tightened) CFC taxation.
- **Further topics:** Detailed explanations (partly with examples) are contained in the draft letter:
  - on the tax amount (Section 10 FTTA): Explanations on the determination, qualification and taxation (in marginal no. 514 et seqq.).
  - on tax credits (Section 12 FTTA): among other things, confirmation of the previous BMF opinion that a credit against trade tax is out of the question (in marginal no. 662 et seqq.).
  - on the concept of permanent establishments within the meaning of Section 20 (2) FTTA (in margin no. 997 et seqq.).
  - Burden of assessment (marginal no. 215 et seqq., 326): Distribution of the burden of ascertainment according to general principles, tax administration bears the burden of ascertainment for tax-increasing facts and the taxpayer bears the burden of ascertainment for tax-reducing

facts; extensive catalogue for which the taxpayer bears the burden of ascertainment (marginal no. 217), inter alia refutation of the assumption of cooperation through concerted behaviour, existence of active income.

### 3. Outlook

Until 4 September 2023, the associations can comment on the draft. The publication of a final version of the application decree is therefore not expected before October 2023.

It should also be noted that there are planned legal changes to CFC taxation. In the draft bill for a Minimum Tax Directive Implementation Act, it is planned as an "accompanying" measure to lower the low tax threshold (Section 8 (5) FTTA-draft) from the current 25 per cent to 15 per cent as of 2024, which should significantly reduce the factual scope of application of CFC taxation. In addition, the trade tax liability of CFC tax amount is to be abolished as of the assessment period 2024). According to the explanatory memorandum, both measures serve to achieve synchronisation with the global effective minimum taxation.

However, the new application decree does not yet refer to the draft bill for a Minimum Tax Directive Implementation Act and continues to focus on a low tax threshold of 25 per cent.

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Please do not hesitate to speak to your direct contact at KPMG AG Wirtschaftsprüfungsgesellschaft if you have any questions.

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