

## Overview of latest German tax legislation

Germany reduces interest on late tax payments  
and refunds significantly

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With a draft bill concerning the interest rate for interest on tax payments and refunds, the German Ministry of Finance (BMF) finally reacts to the German Constitutional Court decision of August 2021 according to which the interest rate for interest periods as from 1 January 2019 is unconstitutionally too high and must be re-designed retroactively to be constitutional. The BMF draft bill proposes a new interest rate of 0.15% per month, i.e., 1.8% p.a., for interest periods from 1 January 2019. This interest rate replaces the former rate of six percent p.a. and shall apply equally to interest on tax payments and refunds. According to current plans, the Federal Cabinet will pass the government draft bill on 30 March 2022. ►

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Furthermore, the newly elected German government continues the COVID-19 support strategy of its predecessor and plans to enact a Fourth Coronavirus Assistance Act (4. Corona-StHG). With the government draft published on 16 February 2022, the government plans to finalize the legislative process by summer 2022.

A key aspect of the Fourth Coronavirus Assistance Act is the extension of the previously extended loss off-setting provision until the end of 2023. Accordingly, the maximum amount of loss carry-back, which has been increased to EUR 10 million (EUR 20 million in the case of a joint assessment) for the assessment period of 2020, will also apply to the assessment periods of 2022 and 2023. From the assessment period of 2024, the former maximum limit of EUR 1 million (EUR 2 million in the case of a joint assessment) will apply. In addition, in its draft, the government plans to extend the loss carry-back permanently to the two immediately preceding years (instead of one year) from 2022 onwards.

Another key aspect of the Fourth Coronavirus Assistance Act is the extension of the possibility of a degressive depreciation for wear and tear for the tax period of 2022. Thereby, a maximum of 25% per year can be written off for movable assets (capped at 2.5 times the current depreciation rate).

In addition, the government draft contains a further extension of the general statutory deadline for tax returns for the 2020 tax period for advised taxpayers by three months to 31 August 2022. The declaration deadlines for the tax periods 2021 and 2022 will also be extended, though with shorter periods. Other deadlines such as the interest-free waiting period for 2020 to 2022 or the declaration deadlines applicable to non-advised taxpayers will be extended correspondingly.

Due to the ongoing COVID-19 pandemic, the BMF has also taken various steps to continue administrative support measures for taxpayers. These include, among others, extended tax deferrals and reduced advance payments for income and corporate taxes, an extension of the temporary extension of the reinvestment periods for the reserve for replacement procurements, as well as deferrals on tax payments, enforcements, and late payment surcharges. It further includes certain VAT measures related to the COVID-19 crisis (e.g., special treatment for donations of medical equipment).

Regarding additional tax legislation, the BMF is planning to introduce a bill regarding the modernization of (tax) auditing, with key aspects probably being published as early as spring 2022. The much discussed "innovation bonus" on certain technologies fostering climate protection and digitalization will likely not be applicable for the tax period of 2022. A respective legislative process can be expected in the course of 2022.

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## German tax authorities

### ■ Frankfurt regional tax authority issues guidance on tax treatment of distressed debt at debtor level

In its guidance dated 26 July 2021 (reference S 2743 A-12-St 523), the regional tax authority (OFD) Frankfurt comments on the tax treatment of distressed debt at the level of the debtor company in certain specific circumstances. Apparently, the views represented have been agreed at a federal level, so should be relevant across Germany.

Based on long-standing German case law, the waiver, contribution or forgiveness of related-party debt is tax-neutral at the level of the debtor company only to the extent the corresponding receivable was valuable in the hands of the creditor. Hence, where a company is distressed and unable to repay its debt in full, the waiver of this debt by a related-party creditor leads to taxable income from the cancellation of debt to the extent of difference between the amount of debt recorded at the level of the debtor (typically the debt's face value) and the FMV of the corresponding receivable. In specific cases, a restructuring gain exemption is available, but this will often not be a realistic option for purely group-internal financial restructurings.

The question has arisen whether cancellation of debt-income must also be assumed in a liquidation scenario where the liquidated entity has (impaired) shareholder/related-party debt. This is denied by the tax authorities as long as the shareholder does not specifically indicate that it will not seek repayment of the outstanding debt. The mere decision to liquidate the company as such does not amount to a debt waiver, and hence should not lead to taxable income. The same holds true for the insolvency of the debtor company.

The guidance in addition refers to two other techniques that are being used in practice to financially restructure a distressed entity:

- ▶ the non-recourse assumption of debt by the shareholder (which is based on a decision by the Federal Tax Court (BFH) from 2001, which held that such debt assumption transaction cannot be equated to a debt waiver and hence should be possible tax-neutrally); as well as
- ▶ the use of cash contributions to repay debt.

On both transactions the guidance does not provide unrestricted comfort to taxpayers that such transactions would be respected by the tax authorities, but instead demands the tax offices encountering such transactions to align their views with the Frankfurt authorities before any binding rulings are given or where a potentially abusive circumvention of the debt waiver taxation is perceived.

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# ■ German Ministry of Finance issues guidance on favorable tax treatments for employee share plans

On 16 November 2021, the German Ministry of Finance (BMF) updated the circular “Wage Tax Treatment of Share Transfers as of 2021” (the Circular). The Circular supersedes the BMF circular dated 8 December 2009, which commented on the then introduced tax-exempt amount of EUR 360.

With the Fund Location Act (FoStoG) in place since 1 July 2021, the German government intended to encourage employee share ownership in Germany with a focus on small and medium-sized companies (SMEs). The two main elements are

- (1) an increase of the tax-exempt amount for employee share ownership from EUR 360 to EUR 1,440 p.a. (Sec. 3 No. 39 German Income Tax Act) and
- (2) an optional tax deferral for free / discounted shares in SME (Sec. 19a German Income Tax Act).

The Circular now explicitly confirms that the tax-exempt amount of EUR 1,440 is neither applicable to virtual, cash-settled schemes nor to stock options at grant. However, it might be applicable upon exercise of options. Moreover, the extended guidance on deposit fees and administrative costs is surely appreciated, as they shall not result in a taxable benefit if they are borne by the employer for the sake of reducing administrative burdens. Previously, such cost coverage was only without tax implications for the duration of a holding period, whereas in practice, employees are often allowed to keep shares in a centrally organized deposit well beyond minimum holding periods. Thus, the Circular gives better grounds for an argumentation that such cost coverage by the employer may not result in a taxable benefit for the employee.

More clarity on the applicable valuation date is also very relevant in practice: The Circular confirms case law and indicates that now both the date of transfer of shares as well as the date both parties bindingly agree on the transfer might be used to determine the value of shares transferred. However, for the latter it is still not perfectly clear which dates will be accepted by the tax authorities in case of stock option plans and other share plans. For IPOs, the issue price is confirmed not to trigger taxable benefits provided that also third-party investors would have the chance to acquire shares at that value.

It has further been clarified that contractual selling restrictions neither reduce the tax base nor defer the moment of taxation if a sale of shares is not legally impossible (which should not be given in most cases). Moreover, the BMF confirmed that a share purchase price above the tax relevant share price (i.e., generally the lowest quoted share price on the valuation day) does not result in negative employment income.

For the first time, the BMF issues guidance around the valuation of silent partnerships, loans and participation rights. The Circular states that for such instruments, the relevant valuation should generally equal nominal amounts.

In case of a transfer of shares below fair market values, employees of SMEs may elect together with their employer to defer taxation on such discount under certain requirements. Deferred taxation moment is the earlier of the date of sale of shares, termination of employment with the employing company or 12 years since the share transfer date at the latest. The Circular interprets the new law rather strictly, e.g. allowing only shares in the direct employer (not another group entity). Additionally, it further details the size limitations for SMEs (in short: less than 250 employees, annual turnover of max EUR 50 million or a total balance sheet of no more than EUR 43 million), which have to be considered over two consecutive fiscal years. It is worth mentioning that for SME size limitations the BMF takes into account the size of other group companies (if applicable). Also, the shares need to be transferred in addition to the already agreed compensation.

Overall, the more detailed guidance is generally helpful and appreciated, in particular for (but unfortunately not beyond) SMEs that consider awarding real shares to their employees and were hesitant before due to “dry income” tax charges that can now be avoided/deferred. Moreover, the current administration announced further improvements around employee participation.

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### ■ Update: Non-EU entrepreneurs can apply the Tour Operator Margin Scheme until 31 December 2022

As already mentioned in previous issues, the German Ministry of Finance (BMF) stated in its letter dated 29 January 2021 that the special Tour Operator Margin Scheme (TOMS) does not apply for entrepreneurs who have their seat outside the EU member states and who constitute no fixed establishment within an EU member state ("non-EU entrepreneurs"). This letter applies to all open cases.

In a recently issued letter dated 1 December 2021, the BMF has again extended the non-objection regulation for non-EU entrepreneurs, now until 31 December 2022.

Consequently, non-EU entrepreneurs can apply TOMS for travel services which are performed until 31 December 2022, which grants them more time for the implementation of the new VAT evaluation.

Please note that the TOMS section within the German VAT Application Decree has been completely revised by letter dated 24 June 2021. This revised section inter alia considers recent changes in the VAT legislation and adopts certain court decisions.

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### ■ VAT – Ministry of Finance issues decree on consignment stock rules

Since 1 January 2020, a simplification rule for supplies of goods from one EU Member State to business customers in another EU Member State via consignment stocks has been in place. This simplification shall allow such supplies without VAT registration of the supplier in the destination EU Member State. The rules are stipulated in Art. 17a of the EU VAT Directive 2006/112 and Sec. 6b German VAT Law. Looking at these provisions, it is apparent that there are many pre-conditions that must be met to benefit from the simplification. Furthermore, complex VAT consequences arise if certain pre-conditions are not met anymore over time.

By its circular dated 10 December 2021, the Federal Ministry of Finance (BMF) comprehensively amends the German Administrative VAT Guidelines (UStAE), particularly adding a new section 6b. Important points are inter alia:

- ▶ definition of consignment stocks and potential forms of consignment stocks in the sense of the provision
- ▶ details on requirement that supplier is not established in consignment stock country
- ▶ details on necessary usage of VAT-IDs of the participants
- ▶ details on the max. 12-month period of storage
- ▶ details on the application for supplies of gases, liquids and bulk goods
- ▶ details on necessary VAT registration if the pre-conditions are no longer met
- ▶ tolerance rule for small losses (5% of the total stock, in value or quantity) that are accepted without need for VAT registration



## German tax authorities

Suppliers of German companies who act via consignment stocks in Germany must thoroughly meet the pre-conditions for the simplification rule. Otherwise, adverse VAT consequences may arise for them. As the German recipient companies are regularly audited by the German tax authorities, there is a certain risk that such audits are also used for providing information to the German tax authorities potentially competent for the suppliers.

German suppliers making use of the simplification for supplies via consignment stock in other EU member states must also ensure to meet all requirements, because in case of non-compliance they are facing VAT risks in Germany (denial of VAT exemption) and in the country of destination (requirement of VAT registration and sanctions for late registration).

Welcome aspects of the decree are the avoidance of conflicts between former jurisprudence of the German Federal High Court and the newly enacted rules (an application of the new simplification shall prevail over potential consequences of this jurisprudence) as well as the indicated tolerance on the time needed for a VAT registration once the preconditions of the simplification rule are not met anymore. Nevertheless, concrete practical experience in this regard is still to come.

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## ■ Second level compensation (“Spitzenausgleich”) under energy and electricity tax law still in full in 2022

Under certain conditions, companies in the manufacturing sector as defined in Sec. 2 No. 3 of the German Electricity Tax Act (StromStG) can apply for extensive refund from the energy and electricity tax paid under the so-called “Spitzenausgleich” (equalization scheme) of Sec. 10 StromStG and Sec. 55 of the German Energy Tax Act (EnergieStG). This can lead to an additional tax refund of up to 65%, which has a massive impact for several manufacturing companies.

However, one requirement for the tax refund to be granted is that the set annual target values for reducing energy intensity at the level of the entire manufacturing sector in Germany are achieved.

The existence of energy savings is verified by an independent economic research institute. The current report, which refers to the year 2020, concludes that the requirements have not only been met, but been exceeded.

Thus, on 22 December 2021, the Federal Ministry of Finance (BMF) announced that companies in the manufacturing sector will again be able to receive the second level compensation (“Spitzenausgleich”) for energy and electricity tax in 2022.

As a result, the second level compensation (“Spitzenausgleich”) can in principle also be granted in 2022. Therefore, nothing now stands in the way of taking into account the corresponding tax refund as part of the advance payments for energy and electricity tax for energy-taxed natural gas suppliers and electricity-taxed utilities, considering the other requirements, e.g. belonging to the manufacturing sector and operating an energy management system.

However, it is unclear what will happen to the second level compensation as well as the regular tax refund for companies in the manufacturing sector according to Sec. 54 EnergieStG and Sec. 9b StromStG from 2023 onwards. The benefits for the financial relief of companies in the manufacturing sector, which were only limited until 31 December 2022 in accordance with the requirements of EU state aid law, will have to be redefined from 2023. Last year, the BMF had already invited tenders for a research contract to analyze a reassessment of the relief provisions for manufacturing companies in the EnergieStG and StromStG. For the time being, only a broad overview of the need for amendment as well as some ideas how to handle the situation have been published. The final results of the research are expected to be published in the spring of this year. It will then become clear whether and to what extent there will be a redesign of the benefits for companies in the manufacturing sector. We will keep you informed about these developments.

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# Update on German R&D tax credit

In 2020, the German Federal Ministry of Finance (BMF) introduced the R&D tax credit law (Forschungszulagengesetz). It enables German companies regardless of their size or success to claim up to EUR 1 million funding per year for their research and development (R&D) activities. Since the R&D tax credit applies to the entire group of companies, coordination between the eligible German group entities may be necessary in order not to exceed the maximum amount and to enable the appropriate allocation.

The credit stands out as an “above the line benefit” funding opportunity, it is cashed out if the tax credit awarded exceeds the tax liability. Companies could apply for funding in hindsight if the project started after 1 January 2020. Application is flexible and there is currently no critical time for claiming as application is possible up to four years after the end of the fiscal year in which the R&D expenses incurred, starting with the end of the respective calendar year. However, documentation requirements such as employee- and project-specific hour records must be met.

In a letter dated 11 November 2021, the BMF released useful guidance, making the criteria for funding clearer and the R&D tax credit an even greater opportunity for companies in Germany including groups with German affiliates.

One focus of the BMF letter is to provide detailed descriptions for classifying activities as R&D. While the broad definition of R&D also allows the funding of activities of experimental development, the overarching criteria for R&D must be met:

- a) novelty of the R&D objectives or results,
- b) risk of failure and
- c) planned nature of the R&D project implementation.

As 25% of specific R&D costs, such as direct R&D personnel costs as well as contract research, are eligible for funding, all R&D activities must be documented in detail. The guidance contains examples for determining the eligible expenses and the working hours of R&D relevant employees.

Another clarification is as to when R&D projects between affiliated companies are regarded as in-house research or contract research. This eliminates uncertainties in using the R&D tax credit when a company is reimbursed for its R&D costs within its corporate group. Contract research can be assumed between affiliated companies if the following criteria apply cumulatively:

- ▶ targeted contracting of an R&D performing company in the same company group by the parent company or another affiliated company with a special task for a specific R&D project,
- ▶ definition or significant co-determination of the goals of the R&D and the ways of implementation by the contracting company,
- ▶ agreement of a separate fee or fixed budget for the R&D project, and
- ▶ lack of permission of the contracted company without the consent of the contracting company to commission further third parties to carry out subtasks.

If these criteria are met, the contracting company is entitled to claim the R&D tax credit. If the criteria are not met, it can be assumed that the contracted company is carrying out its own R&D project.

Finally, the BMF letter provides guidance regarding the income tax and balance sheet treatment of the R&D tax credit.



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## German tax authorities

### ■ Property tax reform – time to act!

One important tax for owners of real estate located in Germany is the property tax. In the past decades, little attention has been paid to this tax type. The reason was that the tax base was often determined decades ago, which is why in many cases, the property tax has not been questioned for years.

Now that the Federal Constitutional Court declared the tax base for property tax purposes to be unconstitutional in 2018, the government was forced to create a new law to redetermine the tax basis. The new legal regulations were implemented in the meantime. The tax authorities are expected to issue a general order in March requesting the submission of tax returns. It is not expected that every property owner will receive a personal letter from the tax office. Every property owner is required to file an electronic property tax return by 31 October 2022. The tax authorities informed us that extensions of the deadline will only be granted in very limited and individual cases.

The individual tax returns will be based on different valuation models depending on the location of the properties. The individual federal states were not able to agree on a uniform model. While some federal states have adopted a unified model, other federal states have implemented their own valuation procedures. In total, there are five different valuation models spread across Germany.

Independent of the valuation model, the taxpayer is faced with the following challenges:

An inventory / data acquisition and data validation of all properties by the real estate management (in cooperation with the tax department / the responsible unit) is required. The data must not only be collected once but must also be kept permanently up to date in the future. An appropriate process for monitoring the updating of data and reporting obligations shall be implemented. Within the reform, it must be decided how the process of property tax assessment should be organized in the future and which departments (real estate management, tax department, etc.) must be included to ensure timely tax declaration. The tax authorities are apparently preparing for the fact that all declarations must be submitted in digital form. For this purpose, the necessary infrastructure must be created with regard to data, preparation, release and submission of tax returns. Facing these challenges and even if 31 October 2022 still seems far away, the data preparation obliges real estate owners to deal with the issue now.

Our property tax experts at EY will be happy to individually support and help you with facing the challenges and assist you with both data gathering and preparation of tax returns. With PropEY, we have developed our own software to digitally prepare and submit tax returns. We can assist you regardless of location, size or number of your German real properties.

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## German tax authorities

### ■ German Ministry of Finance issues guidance on royalty limitation rule


Since 2018, Germany applies a royalty limitation rule, which has the effect of partially or wholly denying a German tax deduction for intragroup, cross-border royalty payments made to certain licensees which are taxed under a preferential and not OECD nexus-compliant regime. Our [EY Global Tax Alert dated 28 January 2022](#) provides an update of the most recent guidance in this regard.

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### ■ German Ministry of Finance denies application of 2016 court decision on dual consolidated loss rules

In its decree dated 14 January 2022, the German Ministry of Finance (BMF) confirms that it maintains its position regarding the question of non-consideration of negative income in a tax group if such negative income is also considered in another jurisdiction. It is thus reacting to a decision already made by the Federal Tax Court (BFH) in 2016 and announces not to apply such decision in other open cases.

According to Sec. 14 Para. 1 Sent. 1 No. 5 of the German corporate income tax act, negative income of the controlling company or the controlled company in a German tax group is not considered for the determination of the German taxable income if such negative income is considered in a foreign jurisdiction as part of the taxation of the controlling company, the controlled company, or another person. This rule applies, e.g., to group structures where the controlling company is a dual tax resident entity or where it is a foreign-owned German partnership that incurs financing costs which are deducted both in Germany and abroad.



In its decision dated 12 October 2016 (I R 92/12), the BFH ruled on the question of how to interpret the term “negative income” in this regard. According to the court, negative income only exists if a loss remains at the level of the controlling company after the income of the controlled company has been attributed. Now, the BMF is reacting to this judgment with a non-application decree. In contrast to the BFH, the tax authorities look at the income of the controlling company and at the income of each controlled company in isolation for the determination of whether negative income exists (so-called isolated approach).

This isolated approach results in a wider application of the relevant rule and may also apply to controlling companies that incur an overall positive income (after income attribution from its controlled subsidiaries), but incur losses on a stand-alone basis, e.g., from interest deduction. Such financing structures using partnerships were frequently used in the past for inbound acquisitions before a law change in 2017.

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## German court decisions

### ■ BFH rules on asset allocation between headquarter and German p.e.

In a preliminary decision dated 24 November 2021 (I B 44/21) on the granting of a suspension of payment obligations, the German Federal Tax Court (BFH) had to decide on the following case:

A Danish parent company held an investment in a German wind park through a German (tax-transparent) partnership. The German partnership had no own employees; it did however create a German permanent establishment (p.e.) due to its fixed presence on German soil. The tax office auditing the case argued that with the introduction of the authorized OECD approach in 2013, only the people functions exercised should be decisive for allocating assets between headquarter and p.e., and since the only people functions in the taxpayer's structure were the management functions exercised from Denmark, all assets should from that moment be re-allocated from Germany to Denmark. As a consequence, there would have been a German exit taxation gain.

The BFH has granted the taxpayer a suspension of payment obligations, as it has significant doubts that the tax authorities' view is correct. In particular, the court stresses that in its view, personnel functions are not necessarily the only criterion that can lead to a functional allocation of assets to either the headquarter or a p.e., and that in the given case it would appear more appropriate to leave the asset allocation unchanged (i.e. to the German p.e.). Moreover, the court indicates that it might also interpret the "people functions" broader than the tax authorities; it may be appropriate to not just look at people functions exercised by own employees, but to also include employees of service- or subcontracted entities in the assessment.

A more detailed reasoning in this important case can be expected as part of the main proceedings, which are ongoing.

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### ■ BFH rules on allocation of spin-off gain in Organschaft

In case I R 27/18 dated 11 August 2021, the highest German tax court (BFH) had to decide on a question which has created considerable uncertainty among German tax practitioners for many years. The question relates to the treatment of gains from a legal reorganization of a German corporation that is a subsidiary in a German Organschaft tax group and as such has concluded a profit and loss pooling agreement (PLPA) with its parent. Based on old BFH case law regarding the liquidation of an Organschaft subsidiary, the tax authorities have held so far that a gain from a legal reorganization of an Organschaft subsidiary (such as a demerger or split-up gain) was not allocable to the tax group parent and hence was taxable on a stand-alone basis at the subsidiary level. This could have quite detrimental tax effects where e.g. the Organschaft parent had tax losses that otherwise could be used to offset the reorganization gain. The BFH has now clarified – in line with the majority of commentators – that the applicability of its older case law was really limited to liquidation cases, and that in demerger or split-up cases such as the one decided, there was an obligation to consider the gain (or loss) from such reorganization at the level of the tax group parent.

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## German court decisions

### ■ Interpretation of the lock-up period in case of spin-offs

According to the German Reorganization Tax Act (UmwStG), a spin-off can be carried out at book value without triggering a taxable gain if certain conditions are met. In any case the book value approach is excluded if a sale to external persons is completed as a result of the division.

The book value approach also does not apply if the spin-off/demerger is carried out in preparation for a sale (Sec. 15 para. 2 sentence 3 UmwStG). According to Sec. 15 para. 2 sentence 4 UmwStG, this is to be assumed if, within five years of the tax transfer date, shares in a corporation participating in the division which account for more than 20% of the value of the shares in the corporation existing before the division took effect are sold.

Until now, the question of whether the post-division sale ban of sentence 3 has an independent scope beyond the cases of sentence 4 has been controversial. In its judgement of 11 August 2021 (case reference I R 39/18), the Federal Fiscal Court (BFH) has now decided that Sec. 15 para. 2 sentence 3 UmwStG only forms the basis for the presumption of sentence 4 and is not an independent reason for exclusion for a continuation of the book value. As a result, disposals below the 20% limit or after the five-year period has expired are harmless.

The BFH judgment thus also renders obsolete the lower court's view that the post-division sale ban of sentence 3 concerns in particular cases in which contractual agreements regarding a later sale have already been agreed upon between the later contracting parties at the time of the spin-off (lower tax court of Hamburg decision of 18 September 2018, case reference 6 K 77/16). Rather, the 20% limit and the five-year period must always be checked.

Furthermore, the BFH states that the general anti-abuse rule in Sec. 42 General Tax Code (with the wording in force until 2007) was not applicable in addition to the special statutory provisions on the prevention of abuse pursuant to Sec. 15 para. 2 sentence 3, 4 UmwStG.

Taxpayers planning a sale of a spin-off within the 20% limit or after five years should note that the legal situation under the new wording of the general anti-abuse rule of Sec. 42 AO could be different.

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## German court decisions

### ■ No receipt of investment income in case of non-pro rata distribution of profits

The Federal Fiscal Court (BFH, decision of 8 September 2021, case reference VIII R 25/19) decided that if the profit share to which the controlling shareholder-managing director of a GmbH is entitled is retained by the GmbH and credited to a personal reserve account, while the minority shareholders receive a cash dividend, this does not lead to the deemed receipt of a profit distribution to the controlling shareholder.

In the specific case, a resolution on the appropriation of profits by the shareholders' meeting of a GmbH was passed to the effect that the profit shares were distributed to minority shareholders. On the other hand, the share of profits attributable to the controlling shareholder-managing director was placed in the personal reserve account. The reserve was reported as retained earnings in the equity of the GmbH. It was disputed whether the profit share had to be deemed received by the controlling shareholder-managing director with the shareholder decision.

The BFH has already denied the receipt of dividends in the absence of a profit distribution to the majority shareholder (decision of 28 September 2021, case reference VIII R 25/19). First of all, the BFH assessed that a shareholder resolution on the non-pro rata distribution of profits that is effective under civil law should in principle also be recognized for tax purposes. In particular if the partial accumulation of profits is based on economic reasons (internal or self-financing of the GmbH), an abuse of rights within the meaning of Sec. 42 General Tax Code is out of question.

According to the BFH, the resolution on the non-pro rata distribution of profits does not lead to the deemed distribution of profits to the majority shareholder, whose share of the profit is thereby retained. Rather, the majority shareholder's entitlement to payment arises only through the (further) resolution on the appropriation of profits aimed at distribution. Since such a claim was not made for the majority shareholder in the specific case, the latter did not obtain any claim against the GmbH that it could have realized at any time due to its dominant position.

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### ■ Federal Tax Court tightens rules for application of extended trade tax deduction on intra-group letting

Domestic entities as well as non-domestic entities with a permanent establishment in Germany are generally subject to German trade tax. The applicable effective trade tax rate varies depending on the municipality the permanent establishment is located in. However, for entities exclusively administering their own real estate assets, the trade tax base may be reduced by the income derived from such real property, rendering it in most cases effectively to zero (so-called extended trade tax deduction – "erweiterte Gewerbesteuerkürzung", ETTD).

However, ETTD applies only in case the respective entity exclusively administers its own real estate assets and in particular does not carry out a commercial business. This so-called "exclusivity principle" is implemented quite strictly by the German tax authorities and tax courts.

In its recently published decision of 16 September 2021 (IV R 7/18), the Federal Tax Court (BFH) has denied activity requirements for ETTD due to a deemed commercial activity as a result of a so-called business split-up ("Betriebsaufspaltung"). In the case at hand, a real estate owning partnership let out real estate to an affiliated partnership, which carried out an operative business. Both real estate letting and operative partnership were indirectly dominated by the same individuals, however, a GmbH was interposed between the individuals (shareholders) and the letting partnership. Based on the hitherto applicable BFH jurisprudence, an interposed corporation was supposed to "block" any tax relevant influence potentially exerted by the shareholders on the real estate owning entity since the GmbH (corporation) is to be treated as opaque from a tax perspective. Thus, no harmful business split-up (i.e. commercial activity) was hitherto assumed in case of a corporation being interposed between the letting entity and its shareholders. ▶

## German court decisions

With its decision as of 16 September 2021 (IV R 7/18), the IV. Senate of the BFH abandoned this previously held view – at least within the boundaries of its jurisdiction (taxation of partnerships). Thus, in the case at hand, the IV. Senate stated that the individuals behind the interposed GmbH had indeed been able to exert their business influence on both the letting and the operative entity. Therefore, a business split-up (“Betriebsaufspaltung”) was assumed and ETTD was disallowed due to a deemed (overall) commercial business.

The decision is likely to have broad impact on existing corporate real estate structures (many of which “utilized” the hitherto applied “opaque view” to arrange for ETTD on income from intra-group letting activities). It remains unclear as to whether the rationale behind the altered jurisdiction of the IV. Senate might also apply in cases where the real estate letting entity is a corporation (instead of a partnership) since the I. Senate of the BFH formally holds jurisdiction over taxation of corporations and there are specific rules for a business split-up between corporations (“kapitalistische Betriebsaufspaltung”). As a result, there is currently some uncertainty whether the “opaque view” and eventually ETTD might be upheld for intra-group letting in the future (irrespective of the legal form of the letting entity). It is recommended to closely monitor the reaction of the tax authorities to the decision at hand and re-evaluate existing structures with regard to any potential impact.

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## ■ Federal Tax Court elaborates on timing requirements of extended trade tax deduction

As mentioned above, ETTD applies only in case the respective entity exclusively administrates its own real estate assets. This so-called “exclusivity principle” applies both with respect to the activities carried out by the respective entity (activity requirements) as well as with respect to timing (timing requirements) as trade tax is an annual tax levied within the respective assessment period (“Erhebungszeitraum”), which is basically the calendar year.

In its recently published decision as of 27 October 2021 (III R 7/19), the Federal Tax Court (BFH) has further elaborated on the timing requirements of ETTD. In the underlying case, a newly founded German GmbH which came into existence in 2014 later that year acquired German real estate which generated an overall profit in 2014. The GmbH declared this profit to be effectively exempt from trade tax under ETTD. The tax authorities denied ETTD, a view that was eventually confirmed by the BFH on the following grounds: Since the GmbH came into existence with its entry into the commercial register in 2014, an abbreviated assessment period (“abgekürzter Erhebungszeitraum”) started to run from register entry until 31 December 2014. Since the real property was acquired within this time frame (but not initially at its beginning), the GmbH had not exclusively administered its own real estate in the entire time frame. Thus, the timing requirements of ETTD were deemed not fulfilled and ETTD was eventually disallowed.

The decision emphasizes once more the strict formal requirements pertaining to ETTD and their – no less strict – implementation by the tax authorities and tax courts. Had timing requirements in the past become subject to court decisions rather with respect to the disposal of real estate (requirement: at the end of the assessment period), the decision at hand now states that the same formal strictness applies with respect to the acquisition of real estate.

From a practical perspective, the underlying case should be rather exceptional as German real estate investments usually do not yield a profit in the acquisition year (due to i.a. depreciation and financing expenses). Nonetheless, the decision once more stresses the formal framework of ETTD and the risks pertaining thereto.

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## German court decisions

# ■ British limited entity qualifies as German corporate income tax subject even after Brexit

Since the withdrawal of the United Kingdom from the EU, limited companies incorporated under UK law with a domestic (German) administrative seat can no longer rely on the freedom of establishment. The question of their legal capacity is now determined by the so-called seat theory and leads to the loss of civil legal capacity. According to previous case law of the Federal Court of Justice, a British limited entity is then to be treated as a German general commercial partnership, civil law partnership or, in the case of a sole shareholder, as an individual enterprise.

By decision of 13 October 2021 (I B 31/21, NV), the Federal Fiscal Court (BFH) has now decided that, despite the loss of its civil legal capacity, the qualification of a British limited entity as a German corporate income tax subject (within the meaning of Sec. 1 sentence 1, 2 No. 1 Corporate Income Tax Act (CITA)) remains unaffected. According to the BFH, this is confirmed by the provision of Sec. 8 (1) sentence 4 CITA, according to which services and service commitments (e.g. distributions) between entity and shareholders for income tax purposes are to be treated as made between a corporation with legal capacity and its shareholders. As justification, the BFH also points out that the treatment of a foreign entity under corporation tax law does not depend on the legal capacity under civil law, but on the so-called comparison of legal types, from which the treatment as a corporate income tax subject results.

In terms of procedural law, the qualification of the British limited entity as a German corporate income tax subject results in its ability to be a party involved in proceedings before a fiscal court. According to the BFH, the capacity to participate as a party involved in proceedings is not based on civil law, but on the legal capacity under tax law.

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# ■ Transparency register – Tightening of notification obligation rules

The German transparency register was established by the Anti Money Laundering Act (Geldwäschegesetz, GwG) in 2017. The register is intended to record the beneficial owners of entities specified in the Act. A “beneficial owner” is an individual who either owns an entity or exercises other significant control over it. Legal entities are generally not beneficial owners within the meaning of this Act. In case of legal entities – other than foundations with legal capacity – or partnerships, a beneficial owner is an individual holding directly or indirectly 25% or more of the voting rights or of the shares in the capital in the legal entity or partnership or exercising control in a comparable manner. If no individual can be identified as the beneficial owner, the legal representative, the managing partner or the partner of the entity shall be deemed to be the beneficial owner. The information concerning the beneficial owner must be entered in the transparency register and kept up to date.

Until 31 July 2021, the so-called notification fictions (Mitteilungsfiktionen) applied to all companies whose corporate structures were already evident from other publicly accessible registers (e.g. commercial register, partnership register, register of cooperatives, company register). According to the notification fiction, the information recorded in the respective public register was deemed to have been communicated to the transparency register. Thus, in particular, corporations (Kapitalgesellschaften), associations and partnerships were exempted from the obligation to report to the transparency register due to their separate register obligations.

With the Act amending the Anti Money Laundering Act (Transparenzregister- und Finanzinformationsgesetz) that came into force on 1 August 2021, these notification fictions have been abolished without replacement. As a result, among others, all legal entities under private law and registered partnerships are obliged to report their beneficial owners to the transparency register. This obligation also applies to foreign entities if they undertake to acquire ownership of real estate located in Germany or if they hold a beneficial interest of at least 90% in a company owning real estate (Sec. 20 para. 1 GWG). If these foreign companies have already made the necessary entries in a transparency register of another EU member state, the obligation to report to the German transparency register does not apply.

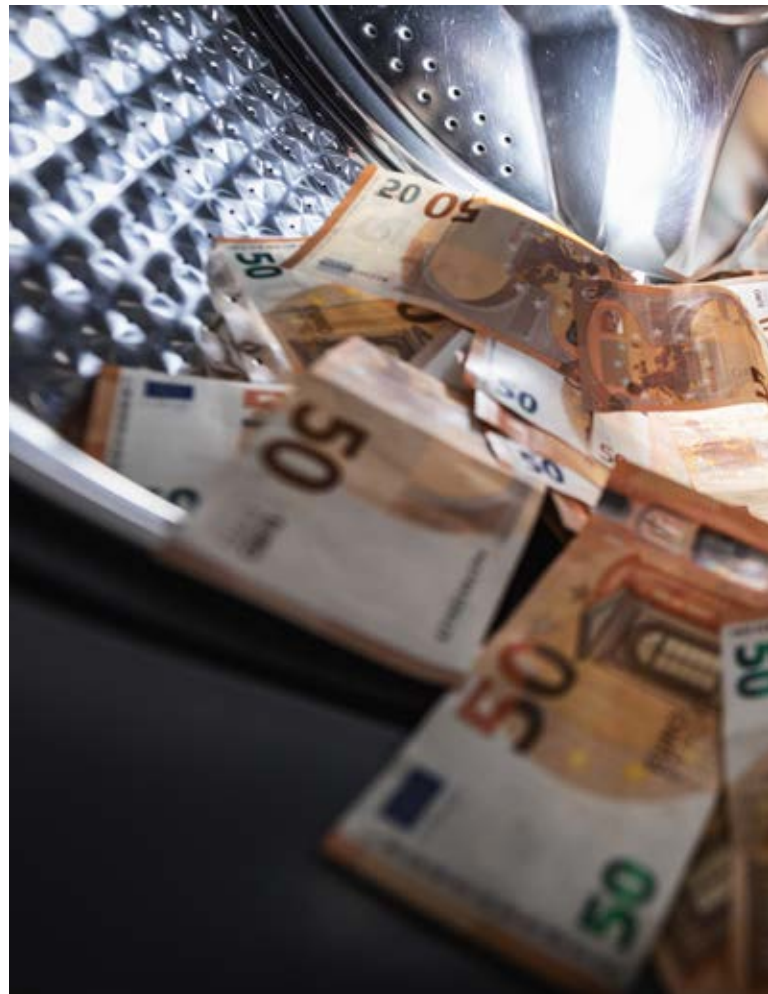
For legal entities under private law and registered partnerships whose obligation to notify the transparency register was previously deemed to have been fulfilled due to one of the notification fictions, transitional periods regarding the notification apply. They have to provide the details of their beneficial owners,

- ▶ if the company is a stock corporation, SE, partnership limited by shares, by 31 March 2022,
- ▶ if the company is a limited liability company, cooperative, European cooperative or partnership, by 30 June 2022,
- ▶ in all other cases by 31 December 2022 at the latest

to the competent authority for entry in the transparency register.

The transition periods do not apply to those who were already required to register in the transparency register prior to the statutory amendments, nor in cases where registration is expressly required.

Violations of the above transparency obligations are administrative offenses and can be punished with a fine.



# ■ Stricter rules for lobbyists to provide more transparency to the public – the new Lobbying Register



The German Lobbying Register Act (Lobbyregistergesetz) came into force at the beginning of 2022. The aim of the Act is to create more transparency to the representation of special interests vis-à-vis politicians. Therefore, a Lobbying Register has been established, which is publicly accessible and intended to disclose to the public how lobbyists influence or attempt to influence the functionaries and decision-makers of the German Bundestag (lower house of parliament) or the German government. According to the German Bundestag, the obligation to register in the Lobbying Register “ensures extensive structural transparency of representation of special interests at the federal level for the first time” (translation by author of this article).

The Lobbying Register Act obliges all individuals or legal persons, partnerships or other organisations, including those in the form of networks, platforms or other forms of collective activities which engage in the representation of special interests themselves or commission such representation on their behalf (“representatives of special interests”) to register in the Lobbying Register if additional requirements are met.

These are that the representation of special interests is carried out in one of the following ways: (i) on a regular basis, (ii) is established on a permanent basis, (iii) is carried out commercially for third parties, or (iv) more than 50 separate contacts have been made in the course of the past three months for the purpose of representing special interests. The Lobbying Register Act also provides for various exceptions of the registration obligation. Also, companies from abroad that conduct representation of special interests themselves or commission must register in the Lobbying Register.

The term representation of special interests is defined expansively in the Lobbying Register Act. According to the Act, “representation of special interests” is any contact made for the purpose of directly or indirectly influencing the process of formulating aims or taking decisions conducted by the bodies, members, parliamentary groups or groupings of the German Bundestag or the German government. This also applies to contacting Parliamentary State Secretaries, State Secretaries, Heads of Directorates-General and Heads of Directorates. However, mere “tagging” on social networks is not considered contacting and thus does not fall under the definition of representation of special interests.

Since 1 January 2022, it has been possible to register in the Lobbying Register on the website of the German Bundestag as the registration office and to make entries therein. In addition to providing information about themselves and the organization for which they work, representatives of special interest must provide further information, among others, about particulars of the identity of the client whose interests they represent, their area of interests and objectives and description of activity, as well as about the financial resources used in the process. This also includes grants and donations, but only for amounts above EUR 20,000. The registration must be made without undue delay. Anyone who, despite an existing obligation, fails to register or makes incorrect, incomplete or belated entries commits an administrative offence. Violations can be sanctioned with a fine up to EUR 50,000 or lead to a note being recorded in the Lobbying Register, as well as other restrictions such as access bans.

The Lobbying Register Act also stipulates that the representation of special interests must be carried out on the sole basis of openness, transparency, honesty and integrity. The Act stipulates that the German Bundestag and the German government shall, with the participation of civil society, establish a code of conduct containing rules for the representation of special interests on the basis of these principles. This code of conduct is available on the website of the German Bundestag. By enrolling in the Lobbying Register, representatives of special interests shall accept this code of conduct. In addition, the Act lays down rules for contacting members of the German Bundestag and the German government. Significant infringements of this code of conduct shall be published in the Lobbying Register.

The Lobbying Register and the code of conduct are intended to create a new regulatory framework for cooperation between politics, business and civil society.

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# ■ Current developments in investment control law

In hardly any other area of law has the regulatory framework changed as quickly and intensively in recent years as in foreign direct investment control law (FDI) in Germany. In 2020 and 2021, the scope of FDI was expanded or tightened a total of four times; most recently on 1 May 2021. This then also led to an increase in corresponding FDI proceedings at the responsible German Federal Ministry of Economics and Climate Protection (BMWK). While a total of 78 proceedings were being conducted in 2018, the number went up to 300 in 2021.

At the beginning of this year, the scope of application of investment control was expanded yet again even though the Foreign Trade and Payments Act and the Foreign Trade and Payments Ordinance remained untouched. However, the Ordinance on the Designation of Critical Infrastructures under the BSI Act (“BSI-KritisV”) has been broadened in several places, resulting in a significant overall increase in the number of operators of critical infrastructures in Germany. This also indirectly expands the scope of investment control, as the (indirect) acquisition of 10% of the voting rights in an operator of such a critical infrastructure by a non-EU/EFTA investor is subject to investment control under Sec. 55a (1) No. 1 AWV and is thus reportable and comes with a stand still obligation. Violations amongst others can be punished with fines as well as imprisonment under certain circumstances. The amendment to the BSI-KritisV affects the energy sector, for example. Electricity generation plants with an installed capacity of 104 MW or more (previously 420 MW or more) are now considered critical. For primary balancing systems, an installed capacity of just 36 MW is sufficient. In the transport sector, airline control centers, port management bodies, port information systems, shipment facilities in sea and domestic ports, and intelligent transport systems have now been included as completely new critical infrastructure. The IT/telecommunications, healthcare, finance and insurance sectors are also affected by the extensions.

The recent failed attempt by the Taiwanese company Global Wafers to take over the Munich-based Siltronic AG shows how critically the BMWK is now examining M&A activities by foreign investors.

It should be noted that, according to the BMWK, 87% and thus by far the largest proportion of FDI proceedings in Germany in 2021 were completed after two months. Only 13%, or the equivalent of 39 proceedings, lasted longer than two months. Experience also shows that any reservations on the part of the BMWi can generally be resolved by commitments. The decisive question in each case is whether the parties involved are prepared to make the required commitments.

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This guide summarizes indirect tax systems in 137 jurisdictions.

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The safety and wellbeing of our guests, EY people, and the local community are our primary concern. Given the unpredictable nature of the situation, EY will not host any physical events for the time being. However, we are pleased to continue to offer webcasts on relevant issues under the following link:

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This quarterly report provides high-level information on German tax developments relevant to foreign business investing in Germany.

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