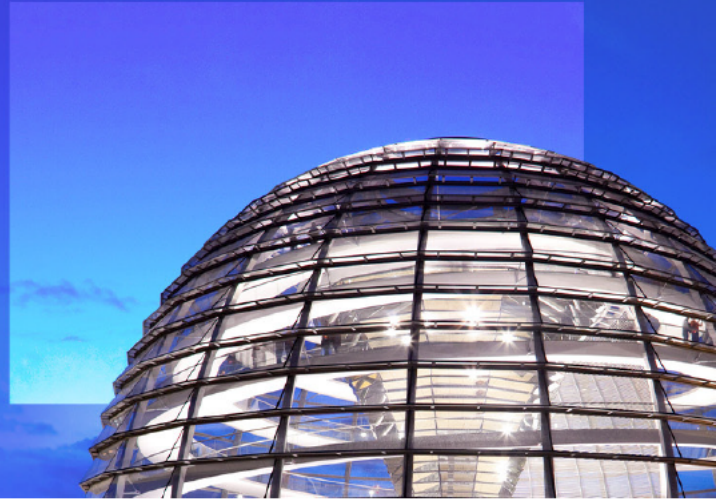


German Tax Monthly

Information on the latest tax developments
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Growth Opportunities Act: Agreement in Mediation Committee and Bundestag Resolution

At its meeting on 21 February 2024, the Mediation Committee of the Bundestag and Bundesrat adopted a compromise proposal for the "Act to Strengthen Growth Opportunities, Investment and Innovation as well as Tax Simplification and Fairness" (Growth Opportunities Act). The mediation procedure was necessary as the Bundesrat had not approved the Act previously passed by the Bundestag on 24 November 2023.

The Act contains a large number of amendments in various areas of tax law. If the Bundesrat approves the Act with the amendments proposed by the Mediation Committee, the main content of the provisions amended by the Growth Opportunities Act can be summarised as follows:

Financial transactions

- Addition of regulations on the arm's length principle in the Foreign Transactions Tax Act for the cross-border deferral of profits in multinational groups of companies regarding financial transactions
- Prerequisites for an income correction (no transaction at arm's length):
The taxpayer cannot credibly demonstrate that (a) he could

have provided the debt service for the entire term of the financing from the outset and (b) the financing is commercially necessary and used for the purpose of the business

or

the interest rate of a cross-border financing relationship with a related party exceeds the interest rate at which the company could obtain financing from unrelated third parties based on a group rating. If it is proven in individual cases that a rating derived from the corporate group rating corresponds to the arm's length principle, this must be taken into account when calculating the interest rate

- Legal categorisation of the pure brokerage service or forwarding of a financing relationship, the typical treasury function and cash pooling as a low-function and low-risk service, which is to be remunerated accordingly (at a low level)
- Regulations already apply from 2024.

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Tax loss deduction

Loss carry-back

- The Mediation Committee cancelled the planned extension of the maximum loss carry-back period to three years; therefore, the maximum period remains unchanged at two years
- Likewise, the planned increase for loss carry-back to 10 million euros (20 million euros in the case of joint assessment) also for 2024 and 2025 respectively the planned increase to a maximum amount of EUR 5 million (EUR 10 million for joint assessment) from 2026 were cancelled, i.e. from 2024, 1 million euros (resp. or 2 million euros for joint assessment) will again apply as the maximum amount.

Loss carry-forward (unlimited loss offset only up to 1 million euros, above that only on a pro-rata basis)

- Temporary increase of the share for 2024 to 2027 from currently 60% to 70% (previous draft: 75%)
- According to the Mediation Committee no increase for trade tax purposes.

Improvement of depreciation possibilities and further investment incentives

The Mediation Committee decided to remove the introduction of a climate protection investment as well as facilitation provided for the immediate depreciation of low-value assets and for the collective item method premium from the Act.

Improvement of depreciation possibilities

- Temporary reintroduction of **declining-balance depreciation** of up to 20% (previous draft: 25%), up to a maximum of 2 times (previous draft: 2.5 times) straight-line depreciation, for movable fixed assets acquired after 31 March 2024 (previous draft: after 30 September 2023) and before 1 January 2025; introduction of declining-balance depreciation of 5% (previous draft: 6%) for residential buildings whose construction is started after 30 September 2023 and before 1 October 2029 or whose acquisition lies within this period
- **Special depreciation for new rental housing:** Extension of the increased depreciation (up to 5% annually) for certain climate-friendly new buildings with building applications / building notifications before 1 October 2029 (currently 1 January 2027); upper construction cost limit will be significantly increased to EUR 5,200 per square metre (previously EUR 4,800) and the maximum assessment basis for special depreciation to EUR 4,000 per square metre (previously EUR 2,500)
- **Special depreciation** (in the year of acquisition and in the four following years): The Mediation Committee decided to increase the maximum amount (from currently up to 20% of the investment costs) only to up to 40% (previous draft: 50%).

Expansion of research allowance (in principle after promulgation of the Act; previous draft: from 2024)

- Among other things, expansion of the eligible expenses to include the reduction in value of depreciable movable

assets of the fixed assets used in the research and development project benefiting from the subsidy, which are necessary and indispensable for the implementation of the research and development project and are acquired after the date of promulgation of the Act

- Increase of the eligible cost share for contract research from 60% to 70%
- Increase of the maximum assessment basis for the research allowance from currently four million euros to ten million euros (previous draft: twelve million euros).

Partnerships

Option for corporate income taxation

- Access for trading partnerships and partnership companies (Partnerschaftsgesellschaften) and registered civil law companies
- Also, for newly established companies and for corporations that have been transformed into partnerships
- Improvements to the fictitious distribution of retained profits
- Entry into force on the day after promulgation of the Act.

Measures implemented by the Secondary Credit Market Promotion Act

The following provisions of the Growth Opportunities Act have already been incorporated into the Secondary Credit Market Promotion Act, which came into force at the end of 2023:

Adjustments to the interest limitation rule (IRL)

- Exceptions to the IRL will only apply to current interest expenses of a year. If interest expenses were increased due

to interest carried forward from the previous year, the exceptions will not apply in future. This means that 2023 will be the last opportunity to fully utilise an existing interest carry-forward

- Adjustments to the exemption regulations in line with the ATAD requirements: The **stand-alone clause** only applies if the taxpayer is not related to any person and does not have a permanent establishment outside the country in which the registered office or place of business is located. With regard to the **equity escape rule**, businesses that could be consolidated with one or more other companies are no longer considered to belong to the group
- Extension of the concept of interest (e.g. also economically equivalent expenses and other expenses in connection with the procurement of borrowed capital).

Adjustments to the Act to Modernise the Law on Partnerships

- Continuation of the joint ownership principle in income taxation
- Procedural changes for associations of persons with legal capacity, among others: Fulfilment of tax obligations by the legal representatives; tax declaration obligation should be primarily incumbent on the association of persons, the association of persons is held liable for late payment surcharges, notification of administrative acts to the association of persons, right of objection/appeal of the association of persons itself
- Continuation of tax benefits for partnerships regarding real estate transfer tax.

The Bundestag has already approved the proposed amendments on 23 February 2024. The Bundesrat still has to approve the mediation result. This could take place in the next session on 22 March 2024, but currently it is uncertain whether the Bundesrat will approve the amended Act. The Growth Opportunities Act then still has to be published in the Federal Law Gazette before it can enter into force.

BFH (III R 27/21): Trade Tax Add-backs of Swap Interest Expenses

In its judgement of 16 November 2023, the German Federal Fiscal Court (BFH) ruled on the question of whether so-called swap interest expenses are subject to trade tax add-backs.

Corporations that maintain a permanent establishment in Germany are not only subject to corporation tax, but also trade tax. Trade tax is calculated on the basis of the trade income. Trade income is the profit from business operations calculated in accordance with the German Corporate Income Tax Act (Körperschaftsteuergesetz - KStG), which is increased or reduced by add-backs or deductions in accordance with the German Trade Tax Act (Gewerbsteuergesetz - GewStG). For example, payments for debts are to be added to the trade income. This is intended to create an assessment basis for trade tax purposes that is independent of whether the business is financed with equity or debt capital (so-called object tax character of trade tax). In practice, it is often disputed what is to be understood as payments for debts in individual cases.

In the case in dispute, the plaintiff concluded a loan agreement with a banking syndicate in July 2006. In this agreement, a long-term loan was granted to the plaintiff to finance several wind turbines with

a variable interest rate. Contracts were concluded with the same banks to hedge the interest rate fluctuations from the loan agreement. In the annual financial statements as of 31 December 2010 and 31 December 2011, the plaintiff formed a so-called valuation unit from the loan agreement and the interest rate swap agreements. In the years in dispute 2010 and 2011, the tax audit concluded that the expenses for interest rate hedging from the interest rate swap agreements (swap interest expenses) were also subject to trade tax add-backs under GewStG as payments for debts.

However, the BFH takes a differentiated view:

- Swap interest expenses are only subject to trade tax add-backs if the loan agreement and the swap transaction form an economic unit.
- In the case in dispute, there is no economic unit. This is because neither the term nor the value date in the loan agreement and in the swap agreements are almost identical.
- The formation of a valuation unit (under commercial law) is not of decisive importance.
- Rather, an economic unit exists if there is significant congruence regarding the parties to the contracts, the dates on which the contracts were concluded and the amounts and terms, and if the due dates of the interest and swap liabilities are aligned.

Note: It was not the subject of the dispute whether the swap interest expenses are subject to the German interest limitation rule. If this were the case, the add-backs for trade tax purposes would not apply for this reason alone. The German interest limitation rule takes precedence over the trade tax add-backs.

BFH (I R 16/21): Taxation of Portfolio Dividends in the Case of a so-called Block Acquisition of Shares

Pursuant to German tax law, dividends received by a corporation from shareholdings in a domestic or foreign corporation are principally tax exempt. However, 5 percent of the receipts are deemed expenses which are not deductible as business expenses. The prerequisite is that the shareholding amounted to at least 10 percent of the share capital at the beginning of the calendar year.

The law provides for a fiction according to which the acquisition of a shareholding of at least 10 percent in the course of the year (so-called acquisition of a shareholding during the year) is deemed to have taken place at the beginning of the calendar year (so-called retrospective fiction). As a result, the tax exemption can be achieved even if the shareholder did not already hold the shareholding at the beginning of the calendar year.

In the case in dispute, the shareholder (plaintiff) had acquired shares from three different sellers during the year in three simultaneous legal transactions. The acquisitions were made in one notarial deed. In the same calendar year, the applicant received dividends from its shareholding. The tax authorities took the view that the acquisition of shares of at least 10 percent during the year had to take place in "one" acquisition transaction and that the fiction does not apply if shares of less than 10 percent were acquired through various acquisitions, but the total acquisitions reached the limit of 10 percent.

In its judgment of 6 September 2023 (I R 16/21), the Federal Tax Court ruled, contrary to the administrative opinion, that the statutory shareholding threshold of 10 percent can be achieved by means of

an acquisition transaction that is economically uniform from the point of view of the acquirer, even if several sellers are involved in this transaction. In any case, a uniform acquisition transaction is to be assumed if the participation is acquired on the basis of a uniform acquisition decision in a causal and temporal context.

The Federal Tax Court was able to leave open the question of whether the fiction is generally applicable to cases in which several (partial) acquisitions are made during one year.

Further court proceedings on the fiction of retroactivity are pending before the Federal Tax Court (Az. I R 30/21). The question at issue is whether a dividend is partly tax-free and partly taxable if several acquisitions are made during the year, in which shares are acquired in the amount of partly above and partly less than 10 percent.

Status of Double Taxation Treaties

By guidance dated 15 January 2024, the German Federal Ministry of Finance [BMF] provided information on the current status of the double taxation treaties (DTTs) and other tax agreements concluded between Germany and other countries and negotiations regarding the treaties. The BMF also addresses the "suspension" of the DTT Russia by the Russian Federation as well as DTTs with non-cooperative tax jurisdictions (within the meaning of the Act to Combat Tax Havens).

German Double Taxation Treaties

Germany currently has DTTs with 96 countries.

The following amendment protocols for existing DTTs (so far) are applicable for the first time from 1 January 2024:

- Bulgaria
- Lithuania
- Luxembourg
- Mexico
- Austria
- Sweden.

A Protocol of amendment to the DTT was newly signed in 2023 with Switzerland. The agreement still needs to be transposed into national law.

New texts for the following (amended) treaties or protocols of amendment were initialled in 2023:

- Norway
- Poland (already initialled on 2 June 2022).

Negotiations for (amended) treaties or protocols of amendment were initiated with the following countries:

- Liberia
- Moldova
- Pakistan
- Ukraine.

It cannot be predicted how long each set of negotiations will last. Negotiations can span over several years.

DTT with Russia

In a note dated 8 August 2023, the Russian Federation announced, without specifying a legal basis, with immediate effect and until further notice, the "suspension" of Articles 5 to 22 and 24 of the DTT between Germany and Russia as well as numbers 2 to 7 of the protocol to this treaty. This concerns all the provisions of the types of income as well as the suspension of the prohibition of discrimination. Under international law, this unilateral suspension does not lead to a cancellation of

the treaty, so that it continues to exist.

Non-cooperative tax jurisdictions

The BMF guidance also refers to the procedure with regard to non-cooperative tax jurisdictions. This concerns Trinidad and Tobago from 2022 and the Russian Federation from 2024. In this context, German taxation rights by the DTT are not affected on the basis of the Act to Combat Tax Havens.

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