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Update: Entry Into Force of General Administrative Regulation for Tax Audits

On 9 September 2026, the "General Administrative Regulation for Tax Audits" (Tax Audit Regulation) was published in the Federal Tax Gazette. It therefore came into force on 10 September 2026. The Tax Audit Regulation replaces the previous Tax Audit Regulation as of 15 March 2000.

The Act on the Transposition of DAC 7 and the Modernisation of the Tax Procedure Law of 20 December 2022 partially amended the statutory provisions on tax audits in the Tax Procedure Law. The aim of these changes was to speed up the tax audit. The Tax Audit Regulation implements the reformed regulations on tax audits within tax administration and is therefore intended to contribute to more risk-based, efficient and timely tax field audits.

For further details see GTM May 2026.

Federal Tax Court (IV R 36/23): Prohibition on Deduction Pursuant to Section 4i Income Tax Act in Conjunction with Dutch Group Taxation

In its judgement of 11 June 2026, the Federal Tax Court ruled that the prohibition on deduction under Section 4i German Income Tax Act (ITA), first sentence, also applies where the tax relief arises abroad within the framework of foreign group taxation. The Federal Tax Court clarifies that Section 4i, first sentence, ITA neither requires that the reduction in the foreign tax base be applied to the same taxable person who is entitled to the special business expenditure deduction in Germany, nor that the expenses abroad are technically taken into account by means of a formal business expense deduction. Rather, it is sufficient that the expenses reduce the taxable profit of a taxable person in the other country.

The claimant was a German partnership, whose sole limited partner was a B.V. resident in the Netherlands. To finance its contribution to the partnership, the Dutch company had taken out loans from its Dutch parent company, also a B.V. The interest paid on these loans was recognised by the German partnership as special business expenses of the Dutch limited partner.

Both the borrower and the lender were subject to group taxation in the Netherlands for income tax purposes in the year in question as a so-called 'fiscale eenheid'. During a tax audit, the tax office took the view that the interest on the loans was subject to the deduction prohibition under Section 4i, first sentence, ITA, which has been in force since 2017.

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This was because the expenses not only reduced the limited partner's domestic tax base via the special business expenditure deduction but also had a tax-reducing effect within the Dutch group taxation system. After the Lower Tax Court of Münster had upheld the claim, the tax office lodged an appeal.

The Federal Tax Court set aside the judgement of the Lower Tax Court of Münster and upheld the tax authorities' position. In the Court's view, the conditions of Section 4i, first sentence, ITA are met. Although the interest on debt borne by the Dutch shareholder constitutes special business expenses and initially reduces his domestic tax base, at the same time it also reduces the taxable profit within the Dutch group taxation system.

The interpretation of the term 'reduction of the tax base in another country' is of particular significance. The Court emphasises that Section 4i, first sentence, ITA does not require tax relief abroad to be granted to the same taxpayer. Nor is it necessary for the expenses to be considered under foreign law in the form of a traditional business expense deduction. The sole decisive factor is that the expenses actually reduce the taxable profit of a foreign taxable entity.

Even within the context of the present group taxation, the interest payments lead to a reduction in the tax base of the 'fiscale eenheid' in the Netherlands. The limited partner's interest payments are set off against the interest income of the Dutch parent company and thus – at least indirectly – reduce the tax base for the 'fiscale eenheid' in the Netherlands. The exclusion of intra-group transactions when preparing the consolidated balance sheet makes it necessary to identify and neutralise corresponding balance sheet items. This results in the elimination of profit-reducing expenses, as well as the corresponding profit-increasing income.

Nor did the exception provided for in Section 4i, second sentence, ITA apply in the case in question. Accordingly, the prohibition on deduction does not apply in so far as these expenses reduce the income of the same taxpayer, which is subject to both domestic taxation and, as can be demonstrated, actual taxation in the other country. The Court considered that the necessary conditions for this were not met.

Furthermore, the Court ruled out any concerns under EU law and held that a reference to the European Court of Justice was not necessary.

Federal Tax Court (I R 57/23): Blocking Effect of Art. 9 OECD Model Tax Convention with Respect to the Formal Arm's Length Principle

The Federal Tax Court held in its judgment of 24 June 2026 (I R 57/23) that Art. 9 (1) of the Double Tax Treaty between Germany and Cyprus (DTT) generally precludes the application of the purely domestic formal arm's length requirements in the context of a hidden profit distribution (so-called blocking effect).

A hidden profit distribution requires that a reduction in assets or a prevented increase in assets, which would not have occurred between unrelated parties, is caused by the shareholder relationship, affects the taxable income of the corporation, and does not constitute an open dividend distribution. In the case of controlling shareholders, German tax law additionally imposes specific formal requirements, according to which related-party transactions must generally be based on a clear, advance, and actually implemented agreement (so-called formal arm's length requirement). In the absence of such an agreement, a hidden profit distribution may arise solely on that basis. Consequently, expenses attributable to the hidden profit distribution are generally non-deductible for tax purposes, even where the remuneration itself complies with the arm's length principle. Under Art. 9 of the OECD Model Tax Convention, however, an adjustment of profits is permissible only where the terms and conditions agreed between related parties deviate from those that would have been agreed between independent parties.

The case concerned a German asset management corporation that remunerated a Cypriot group company at arm's length for services rendered in connection with the acquisition of real estate. Nevertheless, the German tax authorities treated the corresponding payments as a hidden profit distribution because no clear and advance agreement governing the provision of services had been concluded, thereby failing the formal arm's length test. The disputed issue was whether the income adjustment resulting from the hidden profit distribution was barred by the blocking effect of Art. 9 (1) DTT.

The Federal Tax Court affirmed such a blocking effect. It held that Art. 9 (1) DTT relates exclusively to the economic terms and conditions of the transaction and therefore to the material arm's length principle. The specific domestic formal requirements developed for transactions with controlling shareholders fall outside the scope of Art. 9 (1) DTT. Accordingly, Art. 9 (1) DTT prevents an income adjustment insofar as such adjustment is based solely on a breach of the formal arm's length requirements.

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At the same time, the Federal Tax Court emphasised that this blocking effect is limited to the formal arm's length test. Income adjustments based on non-arm's-length conditions under the material arm's length principle remain fully permissible. Furthermore, the blocking effect applies only where the taxpayer is eligible for DTT benefits. This generally requires the existence of a taxpayer with a business activity within the meaning of Art. 3 (1) (f) and (g) DTT, which presupposes an original commercial activity. Mere asset management activities are insufficient for this purpose.

Lower Tax Court of Cologne (6 K 2020/22 and 6 K 33/22): Interest on Withholding Tax on Dividends under European Law Where the Processing Period is Excessively Long

In its judgement of 27 May 2026, the Lower Tax Court of Cologne ruled that an entitlement for interest under EU law in respect of withheld tax on dividends exists even where the Federal Central Tax Office has taken an excessively long time to process the claim (case no. 6 K 2020/22, legally binding). In a parallel judgement, the Lower Tax Court of Cologne further ruled that the interest period begins as soon as the dividend withholding tax (WHT) is paid – provided that an application for exemption was submitted more than three months prior to the dividend payment and the certificate of exemption was not issued within the three-month time limit due to the examination of (later declared contrary to EU law) Section 50d (3) Income Tax Act (ITA), old version (6 K 33/22; appeal pending, Federal Tax Court case no. VIII R 8/26).

In the case at hand, 6 K 2020/22, an Austrian private foundation received dividends from German corporations during the years 2013 to 2017. Dividend WHT and solidarity surcharge were withheld and paid. The foundation applied for a tax refund by means of a refund application dated 19 December 2017 (all information and supporting documents were provided) based on Section 43b ITA (Parent-Subsidiary Directive). However, in its exemption and refund notice dated 29 August 2019, the Federal Central Tax Office refunded only part of the tax, namely up to the residual tax rate of 15 per cent in accordance with the double taxation treaty with Austria. The appeal lodged against this on 25 September 2019 was successful. By an amended notice dated 9 December 2021, the remaining dividend WHT was also refunded. On 21 December 2021, the foundation applied for interest on the refunded dividend WHT.

The Lower Tax Court of Cologne upheld an entitlement for interest under EU law in the event of an excessively long processing period. Due to the processing time of more than 1.5 years (618 days), the tax relief provisions had not been properly implemented, resulting in a withholding of dividend tax that was contrary to EU law (in line with Federal Tax Court case VIII R 32/21, for further details see GTM June 2025).

The interest period must be calculated to the day but does not commence from the date on which the dividend tax was withheld, as the claimant had not sought an exemption procedure in advance. Consequently, the interest period begins only on the day three months after the submission of the application and all necessary documents (to the Federal Central Tax Office) and runs until the date of payment of the refund amount. The rate of interest is based on the statutory interest rate and amounts to 6 per cent per annum until 31 December 2018 and 1.8 per cent per annum from 1 January 2019. The decision is final.

Federal Ministry of Finance: Tax Group: Minimum Term of Profit and Loss Pooling Agreement, Partnerships as Controlling Entities

The Federal Ministry of Finance (MoF) has published a revised guidance on corporate tax groups concerning the minimum term of the profit and loss pooling agreement and partnerships as controlling entities. The new MoF guidance replaces the guidance dated 10 November 2005.

An overview of the key points in the new guidance and a comparison with the 2005 guidance:

Minimum term of the profit and loss pooling agreement

The requirement for a minimum term of five years for the profit and loss pooling agreement is not met if, although the agreement is concluded for five years, it is not entered in the commercial register until a year following the year of its conclusion. A contractual agreement stipulating that the term of the agreement only begins in the financial year in which the agreement is entered in the commercial register is not objectionable. This is in line with the guidance from 2005.

Partnership as a controlling entity

Financial integration of the controlling partnership

Where a partnership acts as a controlling entity, the conditions for financial integration must be met in relation to the partnership itself. Accordingly, it is necessary that at least the shares conferring a majority of the voting rights in the controlled company are held in the joint ownership of the partnership. This is in line with the guidance from 2005.

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The controlling partnership's own commercial activities

- **Scope of the controlling partnership's own commercial activities:** The criterion of the controlling partnership having its own commercial activities is only met if such activities are not merely minor. This is, in principle, in line with the guidance from 2005. A new element is the reference to the tax authorities' rules on the so-called de minimis threshold. Under this provision, income is not reclassified as income from commercial operations if the net turnover from the partnership's own commercial activities does not exceed 3 per cent of the partnership's total net turnover and the sum of EUR 24,500 in the relevant tax period. Conversely, exceeding even one of these thresholds would be sufficient for the activity to be classified as a commercial activity.
- **Holding companies/managing holding companies:** A holding partnership can only be a controlling entity if it carries out its own commercial activity. In individual cases, this may also involve acting as a managing holding company. However, this necessarily presupposes that the partnership holds shares in several subsidiary limited companies and exercises management over them. The mere conclusion of a control agreement with the subsidiaries is not sufficient to establish that actual management is taking place.
- **Provision of other services to group companies:** The criterion of participation in general economic transactions may be met even when a company provides services to only one client. A commercial activity may therefore also exist where a company provides services (such as bookkeeping, IT support or similar) solely to one or more group companies. The prerequisite is that the services are provided and invoiced for a separate arm's-length fee. This is in line with the guidance from 2005.
- **Participation in a commercial partnership:** An asset-management partnership does not itself become commercially active merely because it holds a stake in a commercially active partnership and derives commercial income solely because of what is known as 'commercial infection'. This is in line with the guidance issued in 2005.

Company split-up

A holding partnership formed as part of a company split-up may also be regarded as a controlling entity, as it is originally engaged in commercial activities. This is essentially in line with the guidance from 2005. A new addition is that this also applies if the holding partnership is otherwise engaged solely in asset management.

Temporal aspects

For a group of companies to be recognised for tax purposes, all statutory requirements must, in principle, be met from the start of the controlled company's financial year. However, the controlling company of a tax group does not have to be engaged in commercial activities at the start of the controlled company's financial year. These provisions are entirely new.

Rules on application

The new guidance replaces the guidance dated 10 November 2005 and is to be applied to all outstanding cases.

Update: ECJ Ruling on Real Estate Transfer Tax in Share Deals

In its judgment of 4 June 2026 (Case 'Nova Iberomoldes', C-837/24), issued in response to a Portuguese request for a preliminary ruling, the CJEU held that under the EU Capital Duties Directive (the "Directive"), certain share deals must not be subject to real estate transfer tax ("RETT"). The CJEU judgment may also be relevant for the German RETT rules. For further details see GTM July 2026.

In the meantime, the Austrian Federal Ministry of Finance (Austrian MoF) has confirmed that the CJEU judgment is applicable to the Austrian RETT (in certain cases). In Austria, public limited companies (AG), limited liability companies (GmbH) and European companies (SE) are regarded as companies within the meaning of Article 2 of the Directive. In the opinion of the Austrian MoF, it can be assumed that certain transactions which trigger an acquisition – such as a change of shareholders or a merger of shares – are to be classified as reorganisations (Article 4 (1) of the Directive), provided that shares in the acquiring corporation are issued in each case.

Due to the primacy of European law, the judgment of the CJEU and the Directive are directly applicable. Where such a transaction exists which, according to the case law of the CJEU, is clearly subject to the Directive as a 'restructuring', the Austrian tax authorities must assume that no RETT liability applies.

No statement has yet been issued by the German tax authorities.

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The German Federal Government has now issued a statement on this matter. The key points are:

- Since the publication of the CJEU judgement, the Federal Ministry of Finance (MoF) has been conducting a comprehensive review of the grounds for the decision. This review is still ongoing.
- However, this judgement has no direct implications for German RETT, as it relates to the Portuguese "municipal tax on the transfer of immovable property for consideration" ("Imposto Municipal sobre as Transmissoes Onerosas de Imoveis"). This differs from German RETT.
- The MoF has informed the federal states about the CJEU judgement.

Several appeal proceedings relating to RETT are currently pending before the Federal Tax Court, including, amongst others, case II R 8/23. It remains to be seen whether the Federal Tax Court will comment in this context on the significance of the "Nova Iberomoldes" judgement for German RETT.

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