

## Content

- Government Draft on the Second Economic Recovery Plan
- Guidance of the German Federal Ministry of Finance on the Change-of-Control Rules
- European Court of Justice Rejects the Free Relocation of the Company's Place of Management
- No Fictitious Termination of Business when a Sole Proprietorship is Relocated to Another EU-Member State
- Tax Treaty with United Arab Emirates

## Government Draft on the Second Economic Recovery Plan

On 27 January 2009, the German government released the draft bill of its second economic recovery plan, which has a volume of roughly EUR 50bn. In addition, a lending and debt guarantee program in the amount of roughly EUR 100bn is designed to assure the supply of credit to crisis-ridden companies.

The draft bill includes, aside from measures to strengthen the economy, an investment plan and relief for citizens. The municipal investment program declared has a volume of roughly EUR 17bn. One of the program's objectives is the financing of investments in educational institutions and transportation networks. To facilitate rapid implementation of construction projects, the regulations regarding bid invitations and placements, will be eased for a period of two years.

Agreements were also reached regarding the lowering of the tax burden. With retroactive effect from 1 January 2009, the personal income tax exemption will be increased by EUR 170 to

EUR 7,834. In 2010, the personal exemption is scheduled to increase by another EUR 170 to EUR 8,004. The minimum tax rate is to be lowered from 15% to 14% and a slight change in the rate structure in favor of the taxpayer is to go into effect.

## Guidance of the German Federal Ministry of Finance on the Change-of-Control Rules

Losses incurred by a corporation may be carried forward without time limit provided the corporation retains both its legal and its economic identity (§ 8 (4) KStG – Corporate Income Tax Law). A transfer of more than 50% of a corporation's shares coupled with a contemporaneous injection of predominantly new business assets causes the corporation to lose its economic identity and hence forfeit its loss carryforwards.

In its guidance dated 4 December 2008 the German Federal Ministry of Finance commented on the determination of the injection of predominantly new business assets and the timing of the occurrence of the legal consequences.

The change-of-control rules of § 8 (4) KStG were replaced by loss limitation rules (§ 8c KStG) as part of the 2008 Business Tax Reform Act. Nevertheless, the change-of-control rules remain applicable alongside § 8c KStG, if the transfer of shares began prior to 1 January 2008 and the injection of predominantly new business assets takes place before 1 January 2013.

The statement by the German Federal Ministry of Finance was written in response to two decisions by the Federal Tax Court dated 5 June 2007 (see November issue of the GTM 2007, p. 1), which partially contradicted the view of the tax authorities.

In compliance with the ruling of the Federal Tax Court, the guidance states, that the legal consequences of the change-of-control rules occur to the point of the detrimental transfer of shares (transfer of more than 50% of the shares) and not to the point of the injection of predominantly new business assets.

The reference to the date of the detrimental transfer of shares can be an advantage or a disadvantage, depending on whether profits or losses are incurred after the detrimental change of share ownership. If profits are incurred after the detrimental change of share ownership, the link to the detrimental change of share ownership is a disadvantage, as the profits incurred after this point in time can no longer be offset against losses incurred before this point.

On the other hand, losses incurred after the detrimental change of share ownership can be used for set off against future profits.

In case a company changes the business sector, a specific asset approach is decisive in order to determine whether predominantly new business assets have been injected. The specific asset approach involves asset-by-asset counting of new assets. It is not permissible to net additions against disposals and treat merely the numerical excess of additions over disposals as newly injected assets. To this extent the German Federal Ministry of Finance confirmed its guidance.

For detrimental share transfers that took place before the publication of this guidance in the German Federal Tax Gazette on 31 December 2008, taxpayers have a right to choose regarding the application of the specific asset approach as well as the point in time, when the legal consequences occur.

#### **European Court of Justice Rejects the Free Relocation of the Company's Place of Management**

In the *Cartesio* decision (C-210/06) the European Court of Justice comments on the right of companies to move its seat to another EU-Member State for the first time since the *Daily Mail* decision of 1988 and confirmed the central tenet of its ruling. Accordingly, articles 43 and 48 EC concerning the freedom of establishment cannot be interpreted that they contradict statutory provisions of a Member State which prevent the transfer of seat of a company founded under the domestic law to another EU-

Member State, while remaining registered in the country of origin.

*Cartesio* is a limited partnership founded under Hungarian Law, which was resident in Hungary and later moved its seat to Italy. However, *Cartesio* aimed to retain its identity as a Hungarian company. The registration of this transfer of seat was rejected by the commercial court, in its registry function, because in accordance with the law on entry in the commercial register, the seat of a company subject to Hungarian Law is located in the place where "the company's central administration is situated". Such transfer would only be possible if *Cartesio* is first dissolved in Hungary and then reconstituted under Italian law. The European Court of Justice does not see a violation of European Community Law in this. The question of whether a company can still exist under the law of the country of origin after moving its seat to another EU-Member State can only be resolved by the applicable national law. To this extent, in case of a cross-border transfer of the place of management, the departure of a company, in contrast to the arrival of a company, is not protected by Community Law.

Since the German Act for the Modernization of Limited Liability Company Law and the Deterrence of Abuses (MoMiG) took effect, German Law permits the relocation of the company's place of management to another EU-Member State for corporations. In contrast, under German Law partnerships are not allowed to move

their seat to another jurisdiction without being dissolved. This legal consequence is in compliance with the principles now confirmed by the European Court of Justice.

### **No Fictitious Termination of Business when a Sole Proprietorship is Relocated to Another EU-Member State**

At issue in a recent decision of the Tax Court of Cologne was the question of whether the relocation of a domestic business to another EU-Member State results in the immediate taxation of the hidden reserves based on a fictitious termination of business.

In the case reported hereon, the taxpayer relocated his domicile and his sole proprietorship from Germany to Belgium. He continued to operate the sole proprietorship in Belgium as he did in Germany. The tax authorities stated that the business relocation represented a fictitious termination of the sole proprietorship subject to taxation and assessed a transfer profit. The tax authorities based their view on the case-law of the Federal Tax Court on the so-called theory of final withdrawal (finale Entstrickungstheorie). According to this theory, the criterion for a termination of business is already met if due to the relocation of the business the taxation of the hidden reserves in Germany is no longer ensured.

The Tax Court of Cologne ruled that the case-law of the Federal Tax Court on the theory of final withdrawal is inapplicable in the case reported hereon and based its opinion on European Community Law. In its view, the ruling of

the European Court of Justice in the "Lasteyrie du Saillant" case issued on 11 March 2004 stated that the immediate taxation of hidden reserves in the moment of relocation to another EU-Member State represented a restriction of the freedom of establishment pursuant to Article 43 EC. The ruling further stated that such a restriction can be justified only by imperative reasons in the public interest. The Tax Court of Cologne held that such justification was not present in the case in question; therefore the immediate taxation of the hidden reserves at the time of relocation infringed European Community Law.

The Tax Court of Cologne permitted an appeal to the Federal Tax Court. In the meantime, the Federal Tax Court gave up this theory of final withdrawal in a decision dated 17 July 2008 in a comparable case (see detailed information on the decision in the November issue of the GTM, p. 2). However, it remains to be seen, if the Federal Tax Court follows the opinion of the Tax Court of Cologne in its decision on the appeal.

### **Tax Treaty with United Arab Emirates**

The German Federal Ministry of Finance published a press release on 23 December 2008, according to which it had reached an agreement on a new double tax treaty between Germany and the United Arab Emirates.

The articles concerning the withholding tax on dividends, interest and income from employment as well as the special clause against abuse of the treaty (limitation on benefits) remain substan-

tially unchanged. On the other hand, a withholding tax on pension income and license fees has been introduced.

According to the German Federal Ministry of Finance, the tax treaty will specify the credit method to alleviate double taxation. As the United Arab Emirates generally do not levy taxes correspondingly few taxes will be able to be offset against the taxes levied by Germany as the country of residence.

Furthermore, the exchange of information between Germany and the United Arab Emirates will be adapted to the new OECD standard, leading to a far-reaching exchange of information.

The double tax treaty must still be signed by Germany and the United Arab Emirates and is to be published thereafter. Subsequently the tax treaty must be approved by the Lower and Upper House of the German Parliament. The tax treaty is to take effect retroactively as of 1 January 2009.

### **Imprint**

Responsible\*: Dr. Martin Lenz  
Head of National Tax

KPMG AG  
Wirtschaftsprüfungsgesellschaft  
Marie-Curie-Straße 30  
D-60439 Frankfurt am Main

Editorial Team:

Oliver Dörfler

Dr. Gabriele Rautenstrauch

Marc Binger

Oliver Franz

Christian Schenk

\*Responsible according to German Law  
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