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2009 Tax Act Entered into Force

The Promulgation of the 2009 Tax Act in the Federal Gazette took place on 24 December 2008 and hence, entered into force. In the following the principal features of the 2009 Tax Act concerning corporations are outlined.

No Utilization of Loss Carryforwards due to Retroactive Reorganization

A new paragraph 4 was included in § 2 UmwStG (Reorganization Tax Act). The new regulation aims to prohibit the utilization of loss and interest carryforwards by the transferring entity, that the acquirer would have lost without a retroactive conversion because of § 8c KStG (Corporate Income Tax Act). The provision aims to tackle arrangements where e.g. the acquirer merges the company with a tax effective date prior to the date of acquisition at a value above book, thereby creating a gain which is offset against the loss carry forwards. The utilization of loss and interest carryforwards by the transferring entity is therefore only permitted in cases where the transferring entity would be able to utilize loss carryforwards without making use of retroactive reorganizations in accordance with § 2 (1) and (2) UmwStG. This applies respectively to negative income, which accrued in the retroactivity period (period between tax effective date and registration).

This new regulation applies to reorganizations (including contributions) in case the detrimental acquisition of shares takes place after 28 November 2008. Under the phase-in rules the new regulation does not apply, if

- vendor and purchaser have agreed on or before 28 November 2008 on the later sale of shares (this can be substantiated by written agreements) and
- the reorganization is filed with the Commercial Register until 31 December 2009.

No Preservation of Trade Tax Losses by Inserting a Partnership

§ 10a sent. 10 GewStG (Trade Income Tax Act) will be adjusted regarding trade tax loss carryforwards of a partnership. According to this provision, the loss limitation rules of § 8c KStG

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are applicable if trade tax loss carryforwards are allocated to

- a corporation directly, or
- a partnership to the extent a corporation holds directly or indirectly an interest in the partnership, involving multi-tier partnership structures.

Under § 8c KStG loss carry forwards of a corporation are forfeited if more than 50% of the shares are transferred to an acquirer within a period of five years. In case of a transfer of more than 25% but not more than 50% a pro rata forfeiture applies.

The new rules also apply to interest carryforwards of a partnership if a corporation holds directly or indirectly an interest in the partnership.

The new provisions are applicable to the transfer of shares occurring after 28 November 2008.

Application of Tax Treaties in case of Special Partner Remunerations

Under German partnership taxation rules, income earned by a partner from contractual arrangements with the partnership (loans, leases, etc.) is to be treated as part of the profit share in the partnership and hence, qualifies as business profits (so-called special partner remuneration). In its judgment dated 17 October 2007, the Federal Tax Court stated – contrary to the view of the administration – that special partner remunerations do not qualify as business profits of an enterprise in the meaning of tax treaties, unless explicitly mentioned in the treaty. Rather they fall under the more specific articles of a tax treaty, e.g. the interest article. For inbound cases the consequence would be that Germany loses the right to tax such income under most of the tax treaties.

Under § 50d (10) EStG, the German right to tax shall be secured by classifying special partner remunerations as business profits and hence for the purposes of tax treaties taxable in Germany. The new provision shall also apply for trade tax purposes.

On the other hand, special partner remunerations paid by a foreign partnership to a German resident partner (outbound case) shall not be excluded from the German tax base (by applying for example an exemption for permanent establishment income), in case the foreign state does not tax special remunerations as business profits.

The new rules apply retroactively to all open tax assessment periods.

Losses with a Foreign Nexus (§ 2a EStG)

In its current form, § 2a EStG restricts the offset and deduction of certain foreign losses. Such losses may be netted only against positive income of the same type that arises in the same foreign jurisdiction.

In response to decisions by the European Court of Justice (ECJ) and a pending EC treaty infringement proceeding, the 2009 Tax Act limits the application of § 2a EStG to losses arising in so-called "third countries" (non-EU/EEA countries).

It permits the losses arising in EU or EEA countries to be netted against German-source income where the applicable tax treaty avoids double taxation under the credit method.

The amended terms of § 2a EStG will apply to all tax assessments that have not yet become final.

Losses of Foreign Permanent Establishments

Through 1989, foreign permanent establishment losses could be deducted in Germany despite the application of a tax treaty exempting corresponding gains from German taxation (§ 2 (1) sent. 1 and 2 AuslInvG – International Investment Act). Currently, losses so deducted are subject to recapture only to the extent of subsequent profits derived on or before 31 December 2008. Under § 8 (5) sent. 2 AuslInvG, recapture would apply without time limit.

Taxation of Non-Resident Taxpayers

Under § 49 no. 2 (f) EStG income from leasing real property and licensing rights for a period of limited duration constitutes German-source business income even in the absence of a domestic permanent establishment. This means that not just capital gains from a sale as previously but also current income underlie the same principles in determining taxable income.

The assessment procedure under § 50 EStG for non-resident taxpayers is

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modified to apply the standard progressive rates without the current minimum tax rate of 25%. However, no personal exemption (zero-bracket amount) applies. In principle, income of non-resident taxpayers which is not subject to taxation in Germany is not taking into account for purposes of calculating the tax rate (progression clause, § 32b (1) sent. 1 EStG).

As under current law, the tax withheld on income from employment or from capital and the tax withheld under § 50a EStG still constitutes satisfaction in full of a non-resident taxpayer's German tax liability. However, the exceptions to this principle are materially expanded, thus subjecting non-resident taxpayers to the assessment procedure in many cases.

The new provisions apply from the 2009 assessment period onwards. The assessment procedure under § 50a EStG applies to income derived on or after 1 January 2009.

Treaty and Directive Shopping

The withholding tax on certain income from capital (such as dividends) received by foreign corporate entities will be reduced from 25% to 15% (§ 44a (9) EStG). The provision intends to adjust the withholding tax rate to the corporate tax rate of 15%. In the future the reduction is limited to recipients meeting the activity requirements under the anti-treaty/directive shopping provision of § 50d (3) EStG.

Exchanges of Shares

According to § 23 (1) UmwStG in the case of a contribution of business assets below fair market value the absorbing entity steps into the legal position of the transferring entity, in particular with regard to the values of the assets transferred. The former provision of § 23 (1) UmwStG was limited to contributions in-kind other than shares. In consequence of the amendment of law the exchange of shares will be included in the future and arrangements to avoid a future taxable recapture through an exchange of shares below fair market value will not be able any more.

A phase-in rule is not provided.

Distributive Shares of Partnership Losses (§ 15a EStG)

The 2009 Tax Act restricts the deduction of losses by a limited partner. Subsequent contributions made when the partner's capital account was negative will only have a positive loss utilization impact with respect to losses arising in the same fiscal year in which the contribution was made (§ 15a (1a) EStG). This does not apply in case of disposal of interests in the respective partnership.

VAT-Package

The Directives 2008/8/EC and 2008/9/EC both dated 12 February 2008 (so called VAT-Package) lead to wide changes to the German Value Added Tax Act. The changes shall take effect from 1 January 2010 onwards.

The Directive 2008/8/EC appoints a new concept of VAT place of supply of services rules. According to the basic rule (§ 3a (2) UStG – Value Added Tax Act) services from business to business rather to legal entities which have a VAT identification number, will be performed at the place where the customer runs its business.

The basic place for supplies of services from business to end consumers will remain the place where the supplier runs its business (§ 3a (1) UStG).

The implementation of the Directive 2008/9/EC leads to a reform of the rules for input VAT refunds relating to other EU Member States. The application for input VAT refunds must be submitted electronically to the German Federal Tax Office (*Bundeszentralamt*), using an internet platform equipped by the Member State where the taxable person is resident (§ 18g UStG in conjunction with § 61 (1) UStDV – Value Added Tax Operating Regulation). Regularly the application only has to include copies of the documents. There is now one rule for all EU Member States, that the refund application must be submitted to the Member State of establishment at the latest on September 30 of the calendar year following the refund period.

Bookkeeping in a Foreign Country (§ 146 (2a) AO)

Section 146 (2a) AO (General Tax Code) authorizes the tax authorities to grant a request to transfer computer-based accounting systems and other elec-

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tronic records to another member country of the EU or EEA where the following requirements were met:

- The country to which the book-keeping function is being transferred must consent to electronic data access by the German tax authorities and this consent must be submitted to the German authorities.
- The appropriate German tax officials must be notified of the location of the data processing system.
- The taxpayer must have a past record of compliance with its obligations to cooperate, furnish information, and keep proper books and records.
- Complete electronic data access must be possible.
- An administrative assistance agreement must be in place for transfer to an EEA country.

The law requires immediate notification should changes in the first two requirements occur. A retransfer to the domestic territory has to take place where a prerequisite is no longer met.

Where the taxation is not affected the tax authorities may

- accept a transfer of bookkeeping to territories outside the EU/EEA
- abandon a consent of the country to which the bookkeeping is being transferred
- abandon a notification of the location of the data processing system.

Sec. 146 (2a) AO is also applicable where an entrepreneur intends to store invoices electronically in non-EU/EEA territories for VAT purposes.

The new provisions take effect on 25 December 2008.

Expanded Deduction for Real Estate (§ 9 no. 1 GewStG)

The 2009 Tax Act restricts the expanded deduction for real estate under § 9 no. 1 GewStG with regard to separate remuneration paid by business partnerships to their partners. Accordingly separate remuneration paid to a business shall be included in the expanded real estate deduction only, where the remuneration is paid for real property rented/leased to the partnership by its partner. The provisions will take effect for payments based on agreements reached or substantially amended after 18 June 2008.

Abatement of Real Estate Tax

According to existing case law precedents, a successful application for an abatement of real estate tax under § 33 GrStG (Real Property Tax Act) is dependent on the gross profit generated in respect of the property having fallen by more than 20% below its normal level and the taxpayer is not responsible for this reduction in profits. Where a claim for abatement is successful, the amount of the abatement is calculated with reference to the amount of the reduction in the normal gross profit, with 80% of the prevailing rate of real estate tax being waived. The interpretation of an abatement of real estate tax is intended to be more restrictive under the 2009 Tax Act. According to that, real estate tax will be abated to the amount of 25% only where the gross profit generated has fallen by more than 50% below its normal level. If the gross profit is 100% lower than normal, real estate tax will be abated to the amount of 50%. The new provision applies to real estate tax due for calendar year 2008 onwards.

Judgment of the Federal Tax Court regarding the Participation Exemption in case of Distributions to an US S-Corporation

In a case decided by the Federal Tax Court (BFH) dated 20 August 2008 an US S-Corporation was holding 50% of the shares in a German GmbH (limited liability company). The S-Corporation was treated as a transparent entity for US tax purposes. Hence, its income or losses was divided among and passed through to its shareholders.

In the case reported hereon the Federal Tax Court decided that an S- Corporation qualifies for the exemption privilege under Article 10 (2) DTT-USA 1989 (double tax treaty). Accordingly, dividends paid by a GmbH to an S-Corporation holding more than 15% of the shares of the GmbH, are subject to a reduced withholding tax rate of 5% (as compared to the regular 15% rate under the DTT-USA). Under the current double tax treaty Germany-USA a reduction of the withholding tax rate to

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0% is possible subject to certain conditions.

Amended Statutory Regulations on the "Commuter Tax Allowance" Unconstitutional

Until 2006, a flat rate per working day and kilometer of EUR 0.30 for travelling between home and workplace could be deducted from income subject to income tax as income-related expenses pursuant to § 9 Income Tax Act (EStG) or as business expenses pursuant to § 4 EStG. With effect from 2007, the legislature provided that the flat rate of EUR 0.30 can only be deducted from the 21st kilometer travelled onwards. In its judgment of 9 December 2008, the Federal Constitutional Court states that for lack of a reasoning which is viable under constitutional law, these amended statutory regulations are not compatible with the requirements placed by the general principle of equality under Article 3 (1) of the German Constitution, and hence are unconstitutional. Until a new statutory regulation is adopted, the flat rate should be applied retroactively from the very first kilometer travelled.

Amendment of Double Tax Treaty by Belgian-German Administration Agreement

In a jugment dated 13 August 2008 the Lower Tax Court of Cologne had to decide whether a dismissal pay for an individual, who worked in Germany and was resident in Belgium, can be taxed by Germany as employment income or by Belgium as remuneration in consideration of past employment. The double tax treaty between Belgium and Germany as amended on 5 November 2002 allocates the right of taxation for employment income to the state where the employment is exercised (Article 15 (1) DTT-Belgium). On the other hand, pensions and similar remuneration paid in consideration of past employment shall be taxable only in the country of residence.

In 2006 the Belgian and German Ministry of Finance reached mutual agreement inter alia on the taxation of dismissal payments as employment income based on Article 25 (3) DTT-Belgium.

In the case here reported on the German tax authorities based the taxation of the dismissal pay as employment income on the Belgian-German Administration Agreement 2006. According to the opinion of the tax authorities the Administration Agreement was to be applied as an integral part of the tax treaty for which in their opinion no further legislative implementation was required.

In its judgment the Lower Tax Court of Cologne disagreed with this posture and treated the dismissal pay as income from depend employment. The empowerment of Article 25 (3) DTT, which is comparable to Article 25 (3) OECD Model Convention, does in the Court's view not authorize the administration to amend double tax treaties substantially. The Lower Tax Court however regarded the mutual agreement reached between the German and Belgian tax authorities as going beyond a mere interpretation of the tax treaty. While the objective of a mutual agreement procedure is to reach consensus on a coherent interpretation of the treaty and the filling of gaps, such procedure cannot set law. The tax authorities have appealed the judgment.

Interest Payment on Input VAT Refund Claims

At issue in the Federal Tax Court (BFH) judgment of 17 April 2008 was whether interest is due on input VAT refund claims of foreign companies. A company resident in Austria applied for the refund of input VAT for the period from January to March 1999 (8th EU-Directive claim). The tax authorities took the view that no interest has to be paid on refund claims. Hence, the application of the Austrian company was declined by the tax authorities.

The Federal Tax Court states that interest has to be paid on input VAT refund claims of foreign companies pursuant to § 233a General Tax Code. According to this provision the obligation of interest payments to the amount of 6% p.a. arises for full months beginning from the 15th month following the end of the calendar year in which the input VAT refund claim accrues. Each company resident abroad, which filed applications for the refund of input VAT in the past (8th or 13th EU-Directive claims), should therefore examine whether any interest can be claimed.

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With this judgment the Federal Tax Court anticipates the obligation to pay interest on VAT refund claims, which enters into force with the so-called VAT package ("Mehrwertsteuerpaket") from 1 January 2010 onwards. The VAT package has been transposed into national law with the 2009 Tax Act.

Act "Employment Guarantee through Growth Incentives" Promulgated

The Act on the Implementation of Tax Regulations for the Package of Measures called "Employment Guarantee through Growth Incentives" (Gesetz zur Umsetzung steuerrechtlicher Regelungen des Maßnahmenpakets "Beschäftigungssicherung durch Wachstumsstärkung) was promulgated by publication in the Federal Tax Gazette on 29 December 2008 and entered into force on 1 January 2009. This Act especially allows the using of the declining balance method of depreciation for movable assets to the amount of at most 25%. This possibility only applies for movable assets acquired or built in a two year-period, beginning from 1 January 2009 onwards.

Promulgation of Tax Bureaucracy Reduction Act

The Act for Modernization and De-Bureaucratization of the Tax Process (Tax Bureaucracy Reduction Act) was promulgated in the Federal Tax Gazette on 24 December 2008 and hence generally entered into force on 1 January 2009. Find detailed information on this legislation in the September 2008 edition of German Tax Monthly.

Imprint

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