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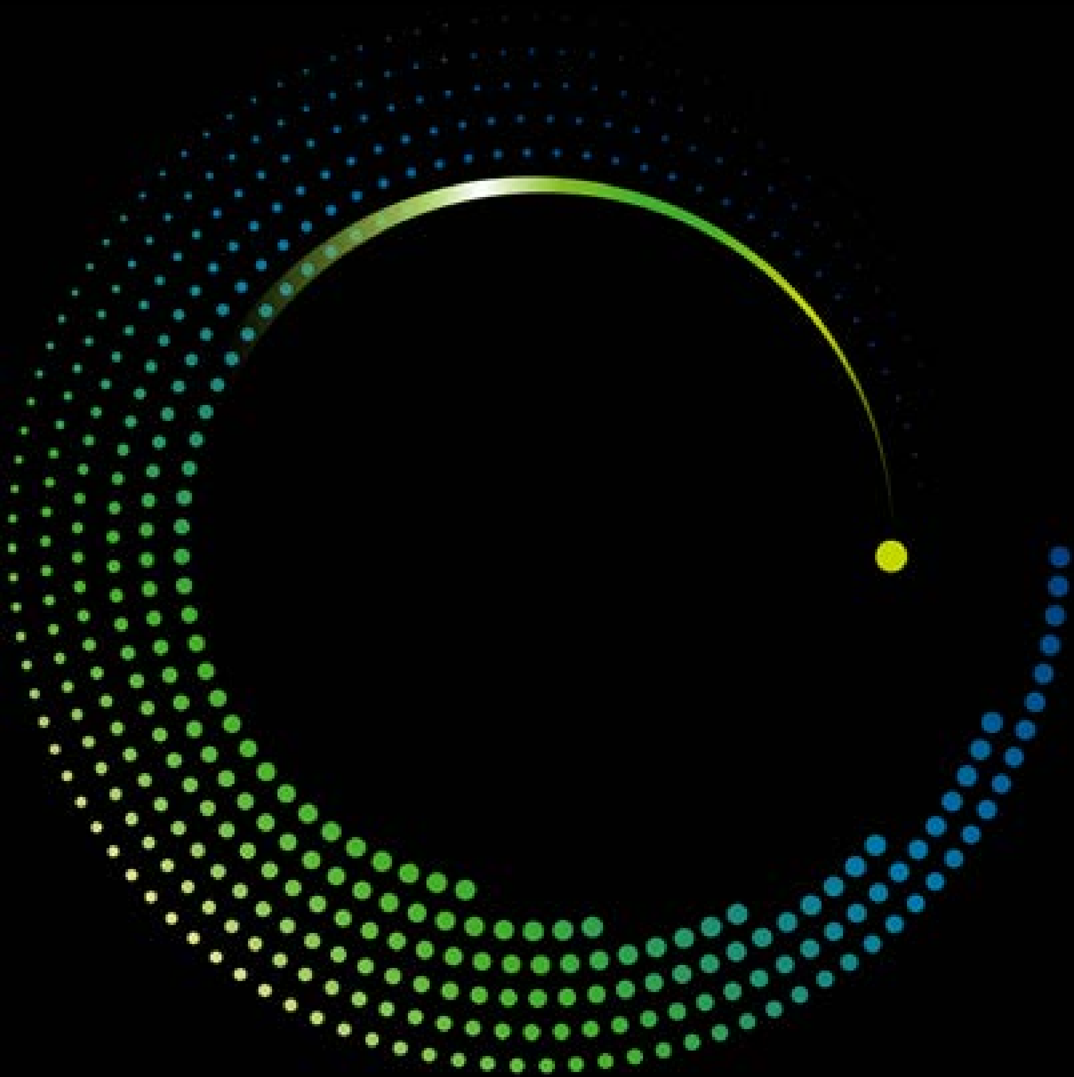

Responding to the challenges ahead

What Tax & Legal departments can do now

MAKING AN IMPACT THAT MATTERS since 1845

Table of Contents

Economic Outlook 2023: Heading towards recession

The year 2022 started with high hopes. After the deep slump in 2020, the world economy grew at a record rate in 2021. The expectation was that, after the end of the Omicron wave, this dynamic rebound would continue in 2022, also in Germany. The war in Ukraine has changed the situation completely. It has let energy prices skyrocket and caused an energy crisis, it has accelerated inflation, prolonged supply chain pressures and multiplied uncertainty and geopolitical tensions. Additionally, the downturns in the two most important export markets, China and the US, have put further pressure on the German economy. From the perspective of year-end 2022, a recession in the coming year will be hard to avoid. The confluence of risks and high inflation take their toll. A look at the expectations of German CFOs in the Deloitte CFO survey shows that companies' financial prospects are close to the record lows of the first Corona wave, while an overwhelming majority of CFOs expect a deterioration of the economic outlook for Germany and the Eurozone in the coming year. At the same time, inflation shows no signs of abating, on the contrary. The official flash estimate for October sees inflation in the Eurozone on another record high of 10.7 percent after 9.9 percent in September. The peak of inflation is still ahead of us and is likely not to be reached until early 2023. The tightening cycle in monetary policy in the Eurozone is therefore set to continue at least until the end of the first quarter 2023.

This extraordinary high inflation is particularly detrimental to consumers, who were supposed to drive economic growth in 2022. Private consumption is under immense pressure and will be a drag on growth going forward as consumers suffer from a loss of real income due to inflation. In September, the European Commissions' Consumer Climate Index reached its lowest level since the survey started in 1985. In October, it went up marginally, but it is still considerably lower than during the first wave of the Covid pandemic. This means that the German economy is likely to contract in the fourth quarter of 2022 and at least in the first quarter of 2023. If inflation falls after the winter, and Germany and Europe can avoid energy rationing, the economy should stabilize towards the middle of the year. A contraction of 0.4 percent is the baseline scenario of Deloitte Research for 2023. If energy rationing measures become necessary and production interruptions follow, the recession would be much more severe, between -2 and -3 percent. What is new in recent economic history is that this recession is coupled with rising interest rates and very high inflation forecasted at seven percent in 2023.

Inflationary pressures currently affect most regions in the world. However, the inflation drivers and the severity of inflation often differ. Thus, monetary policy reactions from Central Banks differ as well, both in terms of timing and the speed in which interest rates are increased. If the resulting interest rate differences persist over time, long-term impacts on foreign exchange rates are to be expected. The depreciation of the Euro against the USD since spring is an example, and different growth prospects as well as the widening interest rate differential have played key roles.

The high inflation rate is also one of the key differences to the last and much deeper recession in 2020, when the German economy contracted by 5.3 percent. It implies that Germany is faced with a phase of stagflation. Another difference concerns the likely shape of the recovery. After the first Corona wave, the German economy rebounded quickly and quite unexpectedly in a V-shaped fashion. One of the key drivers was the quick recovery in China jumpstarting German exports. Unfortunately, neither China nor America currently seems to be able to drive growth in the world economy as each of them is struggling with a downturn and lower than expected growth rates. Therefore, a slower recovery than after the Corona crisis seems likely.

The impact of the downturn differs from industry to industry. Exportoriented industries with high energy intensity, such as chemicals, machinery, automotive, are most affected. Supply chain issues and headwinds from the international markets are the main issues in this segment of the economy. Consumerrelated industries such as consumer goods and retail will be affected by the severe squeeze on household incomes and inflation rates. Therefore, pricing policy and new offers for more price-conscious consumers dominate the agenda in the consumer space. Lastly, the turnaround in monetary policy and rising interest rates hit companies across the board. New capital becomes more expensive, threatening some business models and changing the investment calculus for all companies.

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Corporation Tax

Initial considerations

A. Contingent losses

As a result of structural changes in prices, e.g., in natural gas or energy supply, some long-term contracts with fixed prices may result in losses for one of the parties.While provisions for contingent losses from long-term contracts are mandatory for German local GAAP purposes, such provisions are disallowed under tax GAAP, resulting in book/tax differences without any cash tax relief when setting up these provisions. The transfer of contingent liabilities (including provisions for contingent losses) is subject to specific tax rules and requires careful consideration. A compensation payment to terminate long-term contracts should usually not fall under these specific tax rules and be immediately deductible, though. It is recommended to always consider the tax implications of any amendments of long-term contracts.

B. Impairment of (intercompany) receivables

The economic downturn may result in increased difficulties in collecting outstanding receivables, both third-party and intercompany receivables. There are specific rules addressing the deductibility of impairment losses for German tax purposes. In principle, impairment or non-recoverability of third-party receivables results in tax-deductible expenses. For unrealized losses (i.e. impairment losses), there is an election whether or not to follow a write-down under local-GAAP for tax purposes if the impairment is expected to be permanent. For intercompany receivables, the deduction of losses is severely restricted, and it may be advisable not to claim unrealized losses (i.e.: not to perform a valuation adjustment for tax purposes). To prevent non-deductible losses, it may be advisable to engage in loan restructuring measures depending on the treatment at the level of the debtor.

C. Inventory valuation methods

As a result of the interruption of supplychains, many companies increase the inventory of raw materials and unfinished goods to become more resilient. For tax purposes, an election can be made to presume that the most recently acquired goods are used first (last-in-first-out, LIFO method) unless this violates local GAAP principles (e.g., for perishable goods, this election would not be possible). Particularly where prices are increasing, this may be beneficial as the most recently acquired goods would also tend to be the most expensive goods. Once that this election is made, a deviation from this presumed method requires consent of tax authorities. Where no election has been made in the past, an election should be considered in appropriate situations.

D. Increase in interest rates

As a reaction to increasing inflation rates, central banks are increasing reference interest rates. This has a number of tax implications that need to be considered (also see special section on transfer pricing). As a result of the change in market rates, long-term fixed rate loans with a lower interest rate have an inherent value for the debtor while being less valuable for the creditor. The decrease in economic value does not, however, allow a write-down for tax purposes, as it is not permanent and will reverse upon repayment of the principal. However, the built-in loss may be realized upon a transfer of the loan receivable at FMV.

Careful consideration should be given to the tax effects and opportunities of any refinancing measures in response to the increased interest rates.

E. Foreign exchange effects

As indicated above, central banks are increasing reference interest rates worldwide, but the US Fed has acted earlier so far and has set higher rates compared with the European Central Bank, and USD interest rates are expected to stay above Euro interest rates in the near future. This has resulted in a shift in FX-rates where the Euro has weakened against the US-Dollar. In principle, realized FX-gains or losses are taxable/deductible as ordinary income/expenses for German taxpayers. It should be noted that FX-losses are not covered by the limitations on deductibility of expenses for intercompany loan receivables (see B. above). Unrealized FX-losses can only be deducted if there is a permanent change in value. There is case law according to which FX-rate changes are usually considered temporary, at least for long-term liabilities, unless there was a structural and fundamental change in economic data. Hence, according to this case law, write-downs of receivables/increase of liabilities would only be possible in the tax balance sheet where a receivable is written down (a liability is increased) in the local GAAP balance sheet and the change in FX-rates is a result of such structural and fundamental change. Specific considerations apply to the tax treatment of hedging transactions and the termination of hedging constructs.

Manage your annual tax payments

1. Adjust prepayment amounts of current cash tax

If the estimated statutory profits suggest that taxable income will decrease next year, provide such a forecast and a draft tax calculation to the tax office along with the application to reduce the income tax prepayments. Tax authorities have indicated that an adjustment of corporate income tax prepayments will be granted more easily without strict documentation requirements. Taxpayers can also retroactively apply for an adjustment of previous year prepayments to obtain cash tax prior to the filing of the annual return for such year. Such application should also include a provisional balance sheet and a tax calculation.

2. File a tax return early to obtain tax credits early

Tax credits, e.g., domestic WHT from dividend distributions by a German subsidiary to domestic German shareholders, can in various cases only be claimed through a tax return. Therefore, such cash tax requires that the return is filed early. In some cases, you might even consider filing the return early based on provisional statutory figures. Also, early filing of FY 2022 tax returns will help to obtain tax refunds early if prepayments made exceed the calculated tax and tax authorities deny a retroactive adjustment of prepayments (see above). FY 2022 tax return forms are expected to become available in April 2023.

3. Tax prepayment deferral after restructuring

Restructuring measures within a group may lead to a use of current year losses or loss carryforwards against profits of the surviving group company, subject to certain restrictions within the period of retroactivity. The surviving group company may apply for a (full) reduction of its tax prepayments for the restructuring year and subsequent years.

Avoid unnecessary cash repatriation costs (26.375% domestic WHT)

4. Proactively obtain exemption certificates

Only if an exemption certificate exists, a German company is allowed to directly benefit from treaty protection or from the EU Parent-Subsidiary-Directive through reduced WHT rate at source. Even if dividends are not anticipated, exemption certificates can allow German companies to benefit immediately from treaty protection or the EC parent-subsidiary directive under certain circumstances: Under German tax law, various issues could give rise to deemed dividend distributions, which require to withhold tax unless an exemption certificate exists. It should be taken into consideration that the process may consume considerable time (we currently experience response times of about 6-9 months).

5. German interest, even if non-deductible under limitation may avoid WHT

Under German tax rules generally, a certain EBITDA-related amount of interest expense can be deducted immediately. Any excess amount is deferred to future years (see below, no. 18 for details). However, cash payments of interest which can effectively represent re-patriations of profits are regularly not subject to withholding tax under domestic German tax rules. Various strategies exist to increase a German company's leverage that can allow reaching the desired interest expense levels.

These strategies might be extremely useful if the parent company does not pass the test of the German antitreaty shopping rules and applies a withholding tax of 26.375%.

6. Return equity instead of profits

The return of equity may not be treated as dividends under German tax rules and does not require the paying company to withhold tax. The return of equity may require – amongst others – an assessment of (tax) equity amounts ("steuerliches Einlagekonto") by the tax authorities, which is a standard part of the tax return assessment. Although tax laws govern whether a repatriation is treated as return of equity rather than a dividend, there can also be additional legal requirements which you would like to plan in time.

7. Buy back own shares (treasury stock)

In certain scenarios, a German company could consider buying back own shares. The share price is paid in cash to its parent company and – if structured adequately – does not become subject to withholding tax.

8. Formation of German tax group

Distributions from a German subsidiary to a German parent company are also subject to German withholding tax. However, in the case that the German companies form a tax group (Organschaft), current profits of the subsidiary can be transferred to the parent without the obligation to withhold taxes.

9. Cross border merger

If a German company is part of a cross-border merger, the German activities could give rise to German PE of the surviving company. Any retained earnings of the transferred legal entity should not be subject to withholding tax. The merger could generally be effected on a carry-over basis.

Avoid Penalties

10. Avoid late filing penalties

If timely filing of a tax return cannot be accomplished, you could consider filing a tax return based on provisional figures to avoid the assessment of late filing penalties.

11. Avoid interest charges

If 15 months (18 months for 2023, 17 months for 2024, 15 months thereafter) after the fiscal year end have expired but the final tax return can still not be submitted and additional tax payments are expected, a voluntary tax prepayment may reduce the amount of interest assessed on outstanding taxes (interest rate as per tax law 1.8% p.a.) which is not deductible.

In this context, it might also be worthwhile taking a conservative filing position for pro-visions that have been recognized in the statutory balance sheet. If the issues that gave rise to the provisions may require additional investigation, the corresponding expense might not be deducted in the tax return in the first place but could help later if other ad-justments occur (even in a tax audit) to avoid the post-deadline increase of cash tax liabilities which would give rise to interest penalties. If the result of the investigations allows for tax deductions, these may offset other income adjustment and could therefore avoid additional interest charges.

Defer Income

12. Introduce a deviating fiscal year

If non-tax reasons exist to change a fiscal year from the calendar year to a deviating year end (e.g., adaptation of group standards), the tax for the current calendar year is assessed for the stub period. The tax for the new fiscal year ending in the subsequent year will be assessed after the close of the new deviating fiscal year, i.e.: in the next calendar year. This could generate a cash tax deferral. Tax authority´s consent is necessary in this respect.

13. Transfer of hidden reserves

If certain assets are sold (e.g., immovable property), the profit from the sale will not immediately give rise to a taxable gain but can be reinvested back into assets of similar kinds. If the profit is not reinvested directly, it can be recognized as a reserve reducing the taxable income. The reserve has to be reinvested within four or six years.

It should be considered that if the reserve is not reinvested, it must be reversed at the end of the four/six year-period (increasing the taxable income) and interest of 6% p.a. must be applied for the whole period.

Monetize losses

14. Carry back losses into previous years

Losses can be carried back one year for CIT purposes (not for local trade tax). The use of losses carried back is limited to 10m Euros (as of tax assessment period 2024: 1m Euros). Any remaining loss balance can be carried forward for an indefinite time but will only allow offsetting future income of 1m Euros plus 60% of the remaining positive income. If combined with the introduction of a short fiscal year (#14), the carry-back of losses and the resulting cash refund could be accelerated. Carry-back must be filed in the tax return of the year in which the loss occurred (tax return amendment).

15. Use losses through tax consolidation (Organschaft)

German tax law permits offsetting losses of one group company against positive income of another group company. This requires a parent-subsidiary structure where the parent company owns more than 50% of the subsidiary's shares (votes) at the beginning of the subsidiary's fiscal year and that certain legal steps are taken prior to year-end (signing of profit and loss transfer agreement, approval of the agreement by the shareholders, local court registration).

16. Use losses though accounts receivable factoring

If the legal ownership of the loss company and of the profitable company does not match the parent-subsidiary scheme as required for a tax group, a receivable factoring scheme with built-in discounts will create an expense for the profitable group member (seller) and income of the loss company (factor) upon collection of the full amount of the receivable.

Prepay expenses/royalties

17. Prepayment of expenses/royalties

IP rights, inventory or stock could be sold in advance within the group in order to receive an immediate cash in-flow (discount necessary, accrual setup). If capital gains are realized from such sales, it should be considered if current year tax-losses exist and/or could be generated, e.g., by realizing losses from intercompany sale of assets, in order to reduce cash tax payments resulting from the sale.

Make interest expense tax effective

18. Increase interest deduction above 30% limit

Rising interest rates in combination with the German tax rules, disallowing a taxpayer to deduct interest expense (net of interest income) over and above 3m Euros exceeding 30% of tax adjusted EBITDA, make many more businesses subject to the interest deduction limitation in this year and in the future. The German tax rules, though, foresee a special equity test as an escape – which, if passed, allows to deduct all interest expense.
This equity test can be very complex: Whether the test can be passed should be checked every year prior to the end of the fiscal year. Thus, for taxpayers where the fiscal year equals the calendar year, there is still time to act prior to 31 December 2022. The equity test basically compares the consolidated equity ratio of the parent company and the individual equity ratio of the German subsidiary. If the latter (equity ratio of the subsidiary) is higher, a taxpayer may deduct all interest expense and reduce cash tax liability. For corporations, the equity ratio test is supplemented by the further requirement to demonstrate that at neither the level of German group members nor the level of foreign group members, interest payments made to group companies/affiliates or to third parties who may take recourse to group companies/affiliates do exceed 10% of net interest expense at the level of the respective group entity/affiliate.

Boost distributable profits for repatriation

19. Create additional profits that can be repatriated

If sufficient cash for distributions is available but insufficient book reserves or profits exist, several corporate restructurings (mergers, hive-downs, etc.) can be carried out at fair market values for statutory purposes. These measures may give rise to profits that could then be distributed. At the same time, the transfer could be treated at carry-over basis for tax purposes, which avoids taxable gains to arise from the transaction. Care should be taken, though, about any non-corporate taxes such as Real Estate Transfer Tax.

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Value Added Tax

Optimize the VAT position

1. Make use of temporary reduction in VAT on certain product and services
Many governments have introduced temporarily reduced VAT rates and exemptions to certain supplies (i.e., certain food products, fertilizers, fuels, energy, etc.) and supplies provided for support to those affected by the war in Ukraine. We highly recommend reviewing the product and service classification on whether reduced VAT rates or exemptions are applicable.

2. Stay up to date to see if interest-free VAT deferral and payment schemes can be applied
Check whether interest-free VAT deferral and payment schemes are available in the country where VAT is payable. Such interest-free VAT deferral and payment schemes are often enacted at short notice and are only available for a certain period.

3. Improve the cash-flow position
Consider renegotiating the terms under which the purchase price has to be paid and whether customers are required to make prepayments. Further, in particular countries, the VAT becomes chargeable at the moment the sales invoice is issued, which opens up possibilities to improve the cash-flow position under the applicable legal framework (i.e., issue invoices on the early days of the next month rather than the last day of the month).

Maximize the VAT recovery

4. Explore opportunities to claim foreign VAT earlier
A number of jurisdictions allow the filing of VAT refund claims before the end of the year for which the refund claim is filed, i.e.: in quarterly or half-yearly claims. Where considerable refund amounts are involved, it might be worth considering filing such earlier claims even if this creates some additional administrative costs. An application for the first quarter of 2023 can already be submitted in April 2023.

5. File compliant and complete VAT refund claims
VAT refund authorities have become more focused and scrutinized on the formal requirements which need to be fulfilled to get such VAT refund application accepted. Incomplete applications result either in an immediate refusal or a significant processing delay. A complete application will accelerate the reimbursement process.

6. Increase VAT recovery on employee and travel expenses
Explore the possibility and the formal requirements to be fulfilled regarding documentation for the VAT recovery on employee and travel expenses; make use of actual legislation in certain jurisdictions concerning the cap/statute of limitation periods for retrospective claims for underrecovered input VAT on these expenses.

7. Improve bad debt relief efficiencies

Collect sufficient back-up documentation to claim bad debt relief as early as possible. The tax already paid can be adjusted if, due to demonstrable circumstances, payment by the debtor cannot be expected to be made as soon as it is due.
Should sales be canceled, check whether VAT can be reclaimed (i.e., in the case of advanced payments).

8. Apply for a deferral account for import VAT

In many countries, a so-called deferral account is available allowing importers to defer payment of their duties and of import VAT. In particular countries, it might be even possible to claim the import VAT before the import VAT has to be paid, thereby improving the cash flow position (i.e., in Germany).

9. Check supply chains and ensure correct processing in Tax Compliance Systems

In the case of cross-border supply transactions with different distribution structures, correct VAT treatment is considered to be sufficient. Special attention must be paid in B2B cross-border trade to ensure that a valid and correct VAT ID number of the business partner is used. Further, a restructuring of the supply chains could improve the cash flow position (i.e., applying the customs procedure 42).

VAT return management

10. Ensure timely and proper VAT return filing

Timely and proper filing for early recovery of input VAT and appropriate reporting of output VAT will avoid late filing and late payment penalties as well as interest charges. Further, taxable persons with an input VAT recovery position could improve the cash flow position by filing VAT returns on a more frequent basis.

11. Consider waiving the permanent extension

By making use of the permanent extension for filing preliminary tax returns, the entrepreneur will buy time by making a special advance payment. By contrast, waiving the permanent extension would lead to a cash flow advantage.

Invoicing and tax point planning

12. Request timely invoicing documents from vendors

Consider requiring explicit requests to vendors for timely invoicing and for a proper and complete invoicing format in order to ensure input VAT recovery. Ensure timely processing of purchase orders. Often, input taxes are not claimed in the tax period in which the legal requirements (receipt of supply, receipt of invoice) are met. The improvement of internal control and approval processes will avoid late VAT refunds or even losses of the input tax deduction.

13. Review self-billing arrangements
Self-billing has the advantage that the invoice serving as proof of receipt of services/goods for the refund of input VAT is available as the recipient is the issuer of the invoice on behalf of the vendor.

14. Cash basis taxation and other special schemes
As a rule, tax liability takes effect in the month in which deliveries or services are provided (accrual taxation). Small businesses can opt for cash basis taxation in order to improve their cash flow.

There are also other special schemes available that small and medium-sized businesses should consider, i.e., making use of the VAT exemption for small enterprises.

Review VAT position in relation to one-off transactions

15. Accelerate VAT refund through VAT registration
Even one-off transactions can result in VAT registration requirements in foreign VAT jurisdictions. While this results in additional VAT administrative costs for the VAT regis-tration and related (limited) VAT reporting requirements, such registration can allow to recover foreign input VAT incurred in relation to the one-off transaction much faster than through 9th or 13th EU VAT Directive refund claims (even a voluntary registration, where allowed, should be envisaged for that purpose).

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Energy Tax/Electricity Tax (ET)

Transform into Green Energy

1. Reducing ET payments by settling annual tax payments with amounts subject to ET refund

The most efficient way, from an operational tax cost and a climate perspective, to reduce CO2 emissions is to change the purchase of electricity produced in coal and or nuclear power stations towards the consumption of electricity generated by one's own solar panels on top of the roof of the building and/or on area besides buildings. From an electricity tax perspective, the electricity generated from one's own renewable sources (and generated in highly efficient combined heat and power stations) can be treated as taxexempt (under certain conditions). If these conditions are met, no electricity tax will become due. Therefore, the electricity can be use completely free of electricity tax.

Minimize the ET payments

2. Reducing ET payments by settling annual tax payments with amounts subject to ET refund

In such cases that ET has to be declared and paid for the previous year, you should verify whether you can settle the ET due with the amounts of ET subject to refund for volumes consumed in the previous years as well. Settling the ET due with the ET refundable will reduce the ET payments. Therefore, it is advisable to file the refund applications for volumes consumed in the previous year together with the annual ET return(s) for the taxable volumes. Since refunds require approval by the responsible customs office, it is advisable to file an application of a clearing deferral for the ET due for technical reasons as well to suspend payments until the approval of the refund by the customs office.

3. Reducing ET prepayments by considering volumes subject to ET refund

If ET returns are filed annually, ET prepayments have to be made on a monthly basis. Legally (if this does not jeopardize the tax situation for the customs), there is an opportunity to file an application to reduce the monthly ET prepayments by considering the poten-tial ET refund based on the estimated volumes consumed in the current year. Therefore, you should contact the responsible customs office and apply for a reassessment of the ET prepayments considering potential ET refunds. Please be aware that the refund opportunities according to Sec. 9b of the German Electricity Tax Act and Sec. 54 of the German Energy Tax Act – i.e., refund of 25% of the tax rates paid for those enterprises who can benefit – expires at the end of 2022. The so-called peak relief according to Sec. 10 Electricity Tax Act and Sec. 55 Energy Tax Act will likewise be prolonged and will expire at the end of 2023. The refund according to Sec. 53a Energy Tax Act will be granted until June 30, 2024 (if the requirements are met).

Maximize the ET refunds

4. Review your energy and electricity flows

Explore your energy and electricity flows in order to optimize your refund position. Production entities defined in Sec. 2 No. 3 of the German Electricity Act, referring to the German Classification of Economic Activities, Edition 2003 (WZ 2003), can generally apply for a various number of different refund opportunities for energy products consumed. The individual volumes consumed have to be allocated to a partial and/or a full energy tax refund. Energy costs can therefore be reduced by analyzing the energy flows and the processes in which the energy will be consumed, and identifying the respective volumes. One of the results could be a full refund of energy and/or electricity taxes instead of a partial refund or in general a refund of volumes for which applications for energy tax or electricity tax refunds have not been filed in the past. For time restrictions see our comments mentioned under point 3.

Optimize the ET cash flow

5. Filing annual ET refund applications shortly after the end of the year of consumption

Most of the enterprises applying for ET refunds do so on an annual basis for volumes consumed in the previous calendar year. It is common practice that refund applications for these volumes will be filed shortly prior to the end of the year following the year of consumption. This leads to a liquidity disadvantage that can be avoided by filing an annual refund shortly after the end of the calendar year in which the volumes have been consumed. For time restrictions see our comments mentioned under point 3.

6. Filing ET refund applications during a year

A more efficient cash impact can be achieved by filing periodical ET refund applications during the year of consumption of the energy products. Legally, in most cases, the applicant may choose the calendar quarter or half-year as the relevant period of refund. In individual cases, the responsible customs office may, upon application, also allow the calendar month as the relevant refund period. However, in case of a refund according to the rules about the peak relief ("Spitzenausgleich"), an annual application summarizing the total amounts has to be filed in addition as well. Otherwise, the customs office will reclaim the amounts already refunded for the respective periods. For time restrictions see our comments mentioned under point 3.

Use ET exemptions

7. Applying for licenses for ET exempt consumption of electricity for small electricity producers

With effect from July 1, 2019, the German legislator has implemented a special license procedure, e.g., for a self-consumption of electricity or in case of a supply of electricity to an end consumer in a geographical context that is generated in renewable energy power plants or, respectively, in highly efficient CHP plants with an electrical output of up to two megawatts. The producer of electricity in these plants may self-consume or supply the electricity tax-exempt only as a holder of such a license. Otherwise, ET will become due. This would have a cash impact. However, only in cases of self-consumption without a proper license in place, the ET is generally refundable, whereas the ET on supplies to endconsumers will be definitive without holding a respective license.

8. Applying for licenses for an ET-exempt consumption of electricity for the production of electricity

For the production of electricity, electricity will be consumed as well. These volumes will generally be treated as tax-exempt. If no license is available, the ET due on these volumes is generally refundable. Applying for a license for consuming electricity for the production of electricity might improve your cash flow as well (depending on the volumes). However, in certain cases the volumes have to be evidenced by meters.

New Energy Tax Directive

9. Verifying the opportunities of the proposed Energy Tax Directive. On EU level, a new proposal of a revised Energy Tax Directive is still under discussion

The new proposal is to consider the goals in the Green Deal of the EU Commission achieving the climate goals. It is expected that in the future, fossil fuels will be taxed at higher rates than fuels from renewables. Therefore, it makes sense to review the current consumption of fossil fuels as compared with renewable fuels especially against the background of the investment in new technologies.

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Employer and Mobility Taxes

Improve cash flow

Cross-charging assignment related costs

At the time of payment of costs related to the assignment of an employee to an affiliated foreign company (e.g., salary, benefit in kinds, taxes, etc.), a contemporary and complete cross-charge to the foreign company should be put into practice and immediate payment should be requested. Besides positive effects on cash flow, this will ensure avoidance of tax risks resulting from the denial of business expense deductions for business tax purposes.

Income tax payments for employees on assignment

Although tax return filing deadlines have been significantly extended by the German tax authorities for the tax years 2021 until and including 2023 (e.g., the 2021 income tax return is only due by August 31, 2023), you should nevertheless encourage your employees who are currently on assignment to/from a foreign company to submit the relevant information for the preparation of the income tax returns to the representative tax consultant as soon as possible in order to receive any income tax refunds from the German tax authorities that are related to the assignment. It should be examined closely if it is necessary and consistent with the assignment policy of your company that the employer bears the taxes related to the assignment of employees.

Review Compensation Packages of Assignees

International mobile employees regularly receive allowances as part of their compensation package while working abroad. These allowances serve to compensate for costs or burdens caused by the international assignment. Examples include Cost of Living Allowance, Mobility Allowance, Housing Allowance, Hardship Allowance, Travel Allowance, and Home Leave Allowance.

Reduce Wage Taxes where possible

Apply for Tax Exemption

You should apply for wage tax exemption certificates relating to employees who are currently assigned from Germany to a company in a foreign country that has concluded a double tax treaty with Germany providing for tax exemption of employment income in Germany. This could be beneficial in the case that a net salary agreement has been arranged.

Adjust estimates of employment income taxable in Germany

The German Ministry of Finance requires employers to estimate the employment income of mobile employees that is taxable in Germany and to withhold the applicable wage taxes on a monthly basis. Where the number of workdays taxable in Germany is reduced due to adjusted work arrangements based on remote work policies, the estimates should be adjusted in order to reduce the wage taxes due. This adjustment will particularly help those employers who have concluded net salary arrangements with their employees.

Tax-free inflation compensation premium

During the period from October 26, 2022, to December 31, 2024, employers can pay employees a tax- and social security-free inflation compensation premium of up to EUR 3,000. The inflation compensation premium is intended to relieve employees in view of the rising costs of living and can be paid as a lump sum or in several installments. The tax and social security exemption applies if the inflation compensation premium is paid in addition to the contractual agreed salary (i.e., it is not possible to convert remuneration components that would be paid anyway into to a tax-free inflation compensation premium). Furthermore, it must be made clear on the payslip that the payment is made as an inflation compensation premium because of rising energy prices and costs of living. The inflation compensation premium is fully tax deductible as personnel expenses and thus reduces a company's taxable income and as such its tax burden.

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Customs and Excise

Review your supply chain

1. Can you benefit from preferential origin?

Companies with cross-border movements of goods often have to pay import duties in significant amounts. However, the EU has agreed on many Preferential Agreements with countries importing goods originating in such countries. Therefore, it is worth considering whether you have the possibility to benefit from these agreements, which means that the import duties are either reduced or set to zero. Are you importing from such countries and are not yet benefiting from this preferential treatment? And if not, could you switch your sourcing to a supplier located in one of these countries?

2. Do you benefit from customs procedures?

Many companies have complex supply chains whichlead to the situation that goods cross borders often more than once. If the goods become customs-cleared every time, a high amount of customs duty and import VAT become due. This is often not necessary. It should be considered whether the supply chain can be streamlined to more direct shipments. Further, it is beneficial to use customs warehouses for goods entering the EU and leaving the EU again in order to avoid import duties. In the case of contract processing either ab-road for EU products or in the EU for foreign products, this could be conducted via inward/outward processing. This saves import duties as well. In the case that goods are imported for temporary usage only, the temporary usage procedure should be considered.

Improve your import

1. Is your tariff classification correct?

Import duties and import VAT are calculated based on the customs value and the customs tariff. The customs tariff depends on the customs tariff classification of the imported product. Since the tariff classification leads to different customs duty tariffs, companies should check whether they are using the right tariff classification to avoid overpayments. If it becomes apparent that the company has overpaid import duties or VAT due to incorrect tariff classifications, the company may apply for a refund of the overpayment for the imports of the last three years.

2. Is your declared customs value correct?

The customs value calculation is often difficult and presents opportunities and risks. Therefore, a company should review the calculation of its customs value carefully: e.g., is the basis for the calculation correct (transfer prices to be considered?) or are components such as transportation costs calculated correctly or included twice due to incorrect Incoterms?

Excise Taxes

1. Increase your liquidity by paying later
There are several possibilities to pay your excise taxes at a later stage in order to increase liquidity.Companies can apply for approvals that enable them to pay excise taxes monthly in one sum rather than for each single transaction.

2. Apply for tax exemptions
Excise duties are usually significantly high. Certain deliveries (e.g., to beneficiaries) and production steps (e.g., denaturing of alcohol) are exempt from excise duties. Meeting the requirements for these tax exemptions can be challenging, but if the company does so, it can save a large amount in taxes for regular excise goods (e.g., alcohol, oil, electricity, tobacco etc.)

3. Regular application for energy and electricity tax reliefs
Companies tend to apply for energy and electricity tax reliefs once a year even though it is possible to file applications more often, that is: quarterly. In doing so, companies will have a more regular cash flow rather than having to tie up their money for a full year.

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Transfer Pricing

Adjust your transfer prices proactively

1. Adjust transfer prices proactively
Companies facing challenges brought about by the economic slowdown paired with increasing inflation should examine underlying commercial relationships and related risk allocation between related parties, in order to consider the scope for related parties to adjust or renegotiate transfer prices to reflect economic realities (e.g., overall decrease in operating margins, effect of increased energy or commodity prices, etc.). Furthermore, companies should carefully scrutinize and apply comparable data while determining appropriate margins for routine entities (e.g., using appropriate periods; including loss makers; considering comparability adjustments, etc.) and may consider applying alternative approaches to support the arm's length character of intercompany transactions.

2. Review intercompany contracts
Companies should assess whether existing contracts have price adjustment clauses and extraordinary termination clauses (e.g., for reevaluating intercompany charges and target margins). While drafting new contracts, companies may consider including automatic adjustment clauses for crisis situations to be able to react quickly and ensure flexibility.

3. Examine financial relationships between related parties
Evaluation of ability to serve debt commitments and adjustment of intercompany financing conditions may be necessary during periods of economic downturn and increasing inflation to manage liquidity and secure funding of future investments. Further, a review of interest rates applicable in cash pools may be necessary.

Set your transfer prices proactively

4. Consider the price-setting approach to determine transfer prices
Companies may need to reevaluate existing price-setting approaches or consider applying a proactive price-setting approach to reflect current economic realities to determine future transfer prices. Price-setting approaches should be monitored closely and supported by comprehensive calculations, the contractual basis, outcome testing and documentation.

Consider changes to business model and value chains

5. Economic slowdowns may lead to business restructurings
Ceasing or restructuring certain operations may be inevitable during a slowdown. Companies should consider proper treatment and allocation of costs of ceasing operations. Furthermore, recalibration of existing transfer pricing mechanisms or business restructurings (e.g., transfer of IP) may be required to improve liquidity, efficiency, and effectiveness of the supply chain.

In such an event, companies would need to align costs with anticipated benefits and to be mindful of potential exit taxation issues.

6. As supply chains change, consider changes to functional and risk profiles
Companies should consider that changes in the supply chain may also be accompanied by changes in existing functional and risk profiles of various group entities that would warrant a realignment of the value chain with the underlying transfer pricing. Companies should be mindful that the new way of working (e.g., supported by matrix organizations, adoption of remote or flexible working, etc.) might result in a global spread of significant people functions or key entrepreneurial risktaking (KERTs) functions and could give rise to other tax issues (permanent establishments, wage tax, etc.). Therefore, people movements should be proactively monitored and managed to avoid potential adverse tax consequences resulting thereof.

Manage disputes proactively

7. Consider proactively engaging with tax authorities to manage uncertainties
Apart from ensuring a timely preparation of transfer pricing documentation, companies should consider engaging in an open dialogue with tax authorities to discuss potential implications of the economic climate on profitability and taxable income. Furthermore, existing agreements with tax authorities (such as APAs, etc.) may need to be reevaluated, e.g., with regard to critical assumptions.

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Transfer Pricing of Financial Transactions

Qualification of Loan as Debt/Review Loan Arrangements

1. Evaluate ability to serve existing debt commitments with potentially lower EBITDA levels

Companies facing challenges brought by the economic slowdown should examine how potentially lower EBITDA levels may affect the loans with related parties. Lower EBITDA levels typically imply lower amounts of sustainable debt and interest expense. This effect is reinforced by the observed increase in market interest rates.

2. Review ability to serve existing debt commitments at higher market interest rates

In the case that intercompany loans have been set at floating interest rates – e.g., using Euribor as base rate – existing loan arrangements are already affected as the base rate has increased significantly over the course of 2022: All Euribor rates, which have been negative for the last years, have increased significantly above 0% in 2022. While drafting new contracts, companies may consider including automatic adjustment clauses for crisis situations to be able to react quickly and ensure flexibility – i.e., by adopting floating rates.

3. Increased relevance with respect to choice between fixed and floating interest rates

By the base rate, floating interest rates do contain an element that automatically accounts for market interest rate developments over the term of a loan. Hence, the potential disadvantage stemming from a lower predictability of interest expenses over the term of a loan (for the purposes of liquidity planning and/or tax deductibility of interest) for the borrower may be more than offset by the potential that market rates might decrease over the term of the loan in the current environment when using a floating interest rate and resulting interest savings.

4. Monitor implications of financial covenants of bank debt on intercompany loans

As a result of decreasing earnings and increasing interest rates, financial covenants in loans from unrelated banks may come under stress. The violation of such covenants (typically involving leverage [=Debt/EBDITA] and interest coverage [EBITDA/Interest expense]) may have widespread implications on the financing of a whole group, inclu ding existing intercompany loans (e.g., pressure to raise funds in order to meet bank loan covenants or with regard to the potential applicability of the internal CUP method).

5. Proactively manage extension/renewal of expiring intercompany loans

For intercompany loan transactions maturing in the near term and needing refinanceing, this refinancing should be managed proactively, as debt levels which might have been sustainable in a low interest environment (which was in particular experienced for EUR rates) may not be sustainable in an environment with increased (and potentially even further increasing) interest rates. Given the dynamics of market interest rates, it should be made sure that debt capacity analyses for planned loans reflect the most recent developments.

6. May the capitalization of interest payments be (brought) in line with the arm's length principle?

Capitalizing interest payments when they cannot be paid, when this option is not provided for by the underlying loan agreement, may be met with skepticism by tax auditors. Hence, proactively providing a rationale why this may be in line with the arm's length principle in a given case is recommended.

7. Lower target levels of debt going forward

In the light of the above and as a rule of thumb, setting lower target levels of debt is recommended, where possible. Adjusting intercompany financing conditions may be necessary during periods of economic downturn to ensure and manage liquidity. Companies may wish to consider renegotiating loan terms as third parties would (or might be expected to) do.

8. Review of prepayment/early termination clauses in existing loan agreements

Loan agreements should be reviewed specifically with respect to their option/early termination structure. While the prudent business manager at the borrower's level typically is not interested in an early termination of existing loan agreements in times of rising interest rates, prudent business managers at the level of the respective lender do have such an interest. While such early termination clauses for lenders are not very common, respective considerations become relevant in loan agreements concluded for a fixed term with an automatic extension (typically at the same interest rate), unless one of the parties terminates the agreement in writing.

Cash Pools

9. Review interest rates applicable in the cash pool

In most cases, cash pool rates and spreads for deposits and withdrawals have been set at a time when prevailing market interest rates were significantly lower. Hence, a thorough review is recommended.

10. Monitor the impact of non-effectiveness of interest rate floors regarding the appropriate term (and interest rate) for deposits

For deposit rates, the floor at prevailing negative reference rates in combination with the observed (very) low market deposit rates in general has provided some buffer, as a deposit rate of 0.0% (or marginally above) established by the floor could be shown to also reflect longer deposit terms beyond overnight. A thorough review and action (i.e., eliminate/convert long-lasting stable deposits) has become more important.

11. Monitor the profit of the cash pool leader

The spread between deposit and withdrawal rates can be expected to increase. Hence, the profit of the cash pool leader may also increase compared to profits observed in the past at similar balances (and thereby as well, the tax authorities' potential interest in the profit and its potential allocation across cash pool participants).

Loans in Real Estate

12. Debt capacity considerations in particular for real estate through LTV
The amount of permissible debt in the real estate sector is typically based on loan-to-value ('LTV') considerations. Higher interest rates are being used as discount factors for valuations, whereas other variables (expected future rental income) typically are not expected to change as much. Hence, valuations should decrease and may do so significantly implying that LTV percentages for existing fixed loan amounts will increase. This puts emphasis and pressure on the question of whether a particular intercompany loan should qualify as debt or as equity. Bank loans in the real estate sector often have LTV-based financial covenants.

13. Establish a back-up using alternative measures to LTV
Consider – e.g. – loan-to-cost approaches as back-up/corroboration to LTV bench-marks as these inputs (and consequently also the respective outputs) are not so severely affected.

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Legal*

1. National level
German authorities and legislators are trying to contribute to mitigating the effects in response to the enormous price increases and fluctuations on the energy and commodity markets by measures aimed at helping enterprises to sustain their operations. Businesses should carefully monitor all relevant legislative and other developments and include any results thereof into their planning, strategy, and implementation.

2. European and international level
Also at European level, important legislative and other measures are developed to mitigate the consequences of the energy crisis. Other national legislators are also taking action, which can have an impact on German businesses. Businesses should monitor whether and to what extent measures implemented at European and international level or in other jurisdictions may affect their businesses.

3. Force majeure notifications by suppliers
In the current market circumstances and, in particular when confronted with force majeure notifications from suppliers, companies should review their supply contracts and other contractual relationships with a focus on the exact content and wording of any force majeure clauses, with the aim of having a clear view on the allocation of risks between the parties as well as designing, planning, and implementing a strategy for managing the legal aspects of the relationship. This can help recover damages from suppliers and thereby produce liquidity effects.

4. Manage legal situation with pre-suppliers
Companies relying on suppliers should analyze existing contracts to assess whether their supply relationships with their customers provide for a reservation of self-supply and/or other clauses shifting sub-suppliers' risks to the other party, and to assess whether, given the circumstances, these clauses can be invoked with the aim of having a clear view on the distribution of risks between the parties as well as designing, planning, and implementing a strategy for managing the legal aspects of the relationship.

5. Insurance coverage
In the current situation, companies are well advised to scrutinize whether and to what extent insurance policies can cover damage, e.g., resulting from energy shortages. A corresponding review should extend to all relevant insurance policies, in particular business interruption policies, extended coverage modules, all-risk policies or business closure policies. In many scenarios, businesses should also make an attempt to convince their contractual partners to do the same, so as to ensure recovery of damage incurred to the greatest extent possible. This will require analyses on a case-by-case basis looking at the individual damages and insurance policies, including the applicable terms and conditions as well as time aspects. The results of such analyses should then be used in the financial planning and/or to design, plan and implement a strategy for dealing with the insurer and/or 3rd parties.

*Legal advisory services in Germany are provided by Deloitte Legal.

6. Risk distribution in other contractual arrangements

In order to design, plan and implement a thoughtful and sustainable strategy, parties should review existing contractual arrangements with a focus on risk distribution mechanisms provided for in these arrangements and/or under statutory law.
This can help to considerably reduce financial burdens under existing arrangements and, thereby, bring about the desired liquidity effects. In that context, new legislation and/or measures adopted by authorities should be taken into consideration, as depending on the industry that a business is active in, a change in the risk distribution by operation of law can have a significant impact on liquidity and cash planning.

7. Organization of human resources and tasks

The energy crisis has a massive impact on workforce organization. Employers are not only confronted with an increased number of employees who report sick and/or are unable to come to their workplace for various COVID-19- induced reasons, but now are also facing closure or limited usability of offices, reduced or increased tasks, etc. because of the energy crisis – and at the same time are held to ensure both business continuity as well as profitability. In the current circumstances, businesses should carefully assess their requirements from an employment law perspective based on the various scenarios and should examine and implement possibilities available under German employment law, preferably in mutual agreement with the competent trade union and/or works council and the employees respectively.

8. Reduction of personnel costs by applying for state aid, e.g., short-time work

Against the background of the consequences of the energy crisis that can already be felt in the German market, employers may have to make use of all existing possibilities for minimizing personnel costs. Depending on the industry that employers are active in, minimizing personnel costs can be essential in ensuring liquidity and, thereby, avoiding even more severe consequences for the business and its employees. One very relevant component in that context can be short-time work. By implementing short-time work, employers can reduce the employees' working hours and remuneration and have parts of the remuneration and social security contributions compensated by public bodies. Given that the implementation of short-time work requires a legal basis (i.e., an agreement with the competent union, the works council, or the employees), such legal basis needs to be implemented as soon as possible, if not already in place. On such legal basis, the employer is required to report the loss of work to the competent employment agency and to apply for short-time work compensation. Such compensation can in general cover up to 100% of the employers' personnel costs.

9. Ensuring readiness after the energy crisis

In the medium term, employers should take relevant precautions for the time after the energy crisis and play through and calculate possible restructuring measures (e.g., applying for state aid for the qualification of personnel, reduction of workforce and its connection with short-time work, relocation of tasks or personnel, etc.), so as to achieve Day-1 readiness after the energy crisis.

10. Duty to file for insolvency

Under German law, there is a general obligation on managing directors or management board members of German corporations to apply for insolvency proceedings if certain prerequisites as provided by law (over-indebtedness and inability to pay) are met. In response to the enormous price increases and fluctuations on the energy and commodity markets, the legislator has decided to make temporary adjustments to restructuring and insolvency law.

As a result, both the forecast period for the over-indebtedness test and the planning periods for insolvency and restructuring plans have been shortened to four months, at present limited until 31 December 2023. Furthermore, the deadline for insolvency applications due to over-indebtedness has been increased to eight weeks. It is paramount in the current circumstances to continuously monitor ongoing legislative developments to avoid non-compliant behavior and/or associated consequences, such as personal liability issues of the management.

11. Management liability

In a crisis situation, there are liability risks for members of the executive board in case of payments that have been made by the company after the company has become technically insolvent. Managing directors and/or management board members of German companies should monitor whether their company could be qualified as technically insolvent and, where this is the case, seek professional advice in order to obtain a proper view on what their obligations are and how they can comply with their duty of care without incurring any risk of personal liability. Apart from that, ongoing legislative developments need to be monitored.

12. Review of existing financing arrangements

Financing/loan agreements often provide for regulations dealing with changes in the market environment, deterioration of the borrower's financial situation and/or creditworthiness, material adverse effects, etc. All of these circumstances – and many more – can lead to the right to extraordinary termination and premature repayment obligations being triggered. Moreover, certain developments with respect to individual group companies can have an impact on the entire loan agreement. Also, the fulfillment of obligations under existing financing arrangements can have a considerable impact on possibilities for the grant of financial aids available under German federal, German state and European schemes. In such cases where this has not yet happened, companies should, on the basis and against the background of their financial planning which has been adjusted to energy-crisis-induced effects, review existing financing agreements with the aim of establishing the most relevant clauses to protect against effects that may be triggered by the ongoing events and developments. More in particular, businesses should establish whether there are circumstances or occurrences that might justify an extraordinary termination, whether there are any existing notification obligations, whether there are ways of avoiding a breach of financial covenants and/or, finally, whether there are any clauses in the agreements or regulations under statutory law that would allow them to suspend payments without running the risk of adverse consequences.

Depending on the result of these analyses and other considerations, borrowers may then want to discuss the way forward with their lenders, with the aim of finding an amicable solution. In that context, ongoing legislative initiatives need to be monitored, as they can have a significant impact on financials, for example where moratoriums are enacted by virtue of the law.

13. Schemes for financial aid

Businesses are well advised to continuously monitor ongoing developments and new schemes, and to analyze what grants may be available, so as to ensure business continuity and liquidity, and to apply for financial aid. In particular, companies in dire straits and companies who, based on their mid-case financial planning, expect to be facing a liquidity shortfall or even a technical insolvency should take action now by seeking advice on financial aid that may be available to them, monitoring further developments, discussing the further requirements for a successful application yet to be defined with their banks, as well as, making the relevant applications in a timely way.

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