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International Tax

Germany Tax Alert

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Amended Tax Act 2013 approved

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After a protracted legislative process that started in 2012, Germany's upper and lower houses of parliament approved the Tax Act 2013 on 6 and 7 June 2013, respectively, as part of the "Tax Act implementing the Administrative Assistance Directive and amending tax regulations." The "Tax Act 2013 light" still must be signed by the president and published in the Federal Gazette to become effective, although these steps are expected to be completed in the near future and likely will be a mere formality.

The most important changes in the Tax Act 2013 light are as follows:

Anti-hybrid rule

Corporate shareholders that are resident in Germany or that hold the shares through a German permanent establishment generally enjoy an effective 95% exemption on dividends: 100% of the dividends are treated as exempt, with 5% treated as a nondeductible business expense.

Under the anti-hybrid rule, the 95% participation exemption for dividends is no longer available at the level of a Germany company receiving the dividends if the dividend payment was treated as a tax-deductible expense at the level of the foreign distributing entity. This amendment, which is based on an EU initiative to tackle aggressive tax planning, targets certain hybrid financing structures.

Typical structures that may be affected by this amendment include hybrid instruments in a German outbound structure where Germany characterizes the payments as dividends, but the foreign country characterizes the payments as tax-deductible expenses (e.g. interest expenses). Examples include profit participating rights that qualify as equity from a German perspective and as debt from a foreign perspective, French "ORA" (i.e. bonds that must be redeemed in shares) and Brazilian interest on net equity.

The anti-hybrid rule applies to dividends received in fiscal years beginning after 31 December 2013.

Withholding tax refund claims for hybrid entities

The new rules clarify which person is able to file for a refund of withholding tax where a payment is received by a hybrid entity, a situation that previously was unclear. Germany will follow the classification of a hybrid entity in the foreign country to determine who is eligible to file a refund for withholding tax purposes. Originally introduced to ensure that treaty relief is available in situations in which the person taxed on the income is different from the person eligible for treaty benefits, the new rule could create an additional obstacle in some cases (e.g. where an investment into Germany is made via a US S corporation or via a disregarded LLC that is treated as a corporation for German tax purposes).

The new rules apply to dividends paid after the Tax Act 2013 is published in the Federal Gazette.

Payments from partnership to foreign partner

Under German domestic rules, no deduction is allowed for payments made by a German partnership to its German partners for services or for the use of capital. To apply this concept in a cross-border context, the new rules provide that tax treaty protection will be restricted where payments are made by a German partnership to its non-German partners so that Germany will retain the ability to fully tax the payments. A measure enacted in 2009, aiming at the same result, recently was overruled by the Federal Tax Court.

Taxes incurred in the jurisdiction in which the non-German partner is resident should be creditable for German tax purposes.

The amended provision applies to all open tax years.

Real estate transfer tax (RETT) rules

RETT blocker structures: RETT may be triggered where 95% or more of the shares in a German real estate-owning company are directly or indirectly transferred to a new acquirer or where 95% or more of such shares are combined for the first time in the hands of a single shareholder. These rules apply to both German and non-German entities that own German real estate, and apply, for example, where, in a chain of group companies, new entities are interposed between the (foreign) parent company and the German real estate-owning entity. It is irrelevant whether the entity in question is a real estate-rich company.

RETT blocker structures often have been used to avoid liability to RETT. These structures involve setting up a German limited partnership (KG) that held a 5.1% or greater percentage in the real estate-owning entity. A third party then held a minority interest in the KG. Under existing rules, each partner in a partnership is allocated the same fractional interest in the partnership's shareholdings on a per capita basis, regardless of its economic stake in the partnership. Thus, it has been possible to avoid RETT in group restructurings as long as the minority interest was held by the unrelated third party. RETT blocker structures have become more attractive due to the increasing RETT rates in most German states.

The amended RETT rules now provide that an economic participation (so-called “*wirtschaftliche Beteiligung*”) of 95% or more will count as a combination of shares triggering RETT. An indirect shareholding will be calculated by multiplying the participations in the capital or assets of the entities involved. The new rule on economic participations will apply in conjunction with the existing rules where the combination of shares or transfers of interests in a partnership triggers RETT.

Because it is unclear precisely what "economic participation" means, it is possible that structures other than RETT blocker structures as described above may be affected by the new rule. Both existing structures and planned transactions should be carefully analyzed.

The new rule applies to all transactions carried out after 6 June 2013.

Intragroup restructuring clause: The intragroup restructuring clause, which provides for an exemption from RETT, applies only to certain reorganizations and restructuring transactions as defined in the Reorganization Act (e.g. merger, hive-down, demerger) or to comparable transactions in other EU/EEA member states. The amended intragroup restructuring clause covers contributions (e.g. share-for-share exchanges), as well as other transactions based on the company's articles of association (e.g. liquidations, capital increases, etc.). The other conditions for application of the intragroup restructuring clause, such as certain minimum holding periods and minimum shareholding, have not been changed, which still will make it challenging to apply the intragroup restructuring clause.

The expanded rule applies to all transactions carried out after 6 June 2013.

Other changes

- The Inheritance and Gift Tax Act has been amended to prevent the use of "cash GmbH's" that are subject to inheritance/gift tax relief;
- Certain structures that made use of the retroactive effect for reorganizations under the Reorganization Tax Act for the use of net operating loss carryforwards and interest carryforwards are no longer possible; and
- The Authorized OECD Approach (AOA) is introduced into German law, under which permanent establishments will be treated as separate and independent enterprises.