

# German Tax & Legal News

Monthly Newsletter for Inbound Investors into Germany

## Legislative update

### German tax law changes effective from 2008

In addition to the German Business Tax Reform 2008, which was finalized on 17 August 2007, a number of important proposals are included in the Annual Tax Act 2008. A draft of the Annual Tax Act 2008 was published by the Federal Cabinet on 8 August 2007 (for a detailed overview of the proposed changes, see GTLN 7/2007).

The Upper House of the German Parliament released its first statement on the Annual Tax Act 2008 on 21 September 2007, recommending certain amendments, including the following:

- Revision of the German general anti-abuse rule: The Upper House acknowledges the considerable uncertainty that would arise for taxpayers if the planned amendments to the anti-abuse rule are enacted. The Upper House has suggested that the proposal be modified substantially, although no specific wording has been put forward.
- Disclosure obligation for international tax planning schemes: Contrary to earlier expectations, the Upper House has not proposed the incorporation of the disclosure rules in the Annual Tax Act 2008.

Taxpayers should closely monitor the Annual Tax Act 2008 as it proceeds through the legislative process to determine whether action will be required to respond to the changes. The draft still must be passed by both houses of parliament, with a final discussion in the Upper House scheduled for 30 November 2007, so further amendments are still possible.

## Court decisions

### Federal Tax Court rules on change-in-ownership rule

In a recently published decision, the German Federal Tax Court (BFH) ruled on the interpretation of asset injections under the existing change-in-ownership rules. An injection of assets during a – generally – two-year monitoring period following the share transfer currently leads to a forfeiture of loss carryforwards existing at the time the new assets were injected.

According to the BFH, harmful asset injections must be reviewed on an asset-by-asset basis in all cases, rather than only when the company's line of business changes after the share transfer. Asset injections and asset disposals may not be netted when deter-



mining whether new assets were injected. Therefore, even if the overall value of the assets remains the same, a detailed analysis would have to be carried out to determine whether any of the assets existing at the time of the share transfer had been exchanged.

The BFH indicates that even an increase of assets that is financed internally (i.e. by the company's own cash flow) may be harmful in certain cases. While the court does not provide a final view on this question for all cases, an internally financed exchange of assets will be harmful if the company's line of business was changed after the share transfer. Moreover, the BFH states that a decision issued in 2004 (see GTLN 11/2004) does not contradict the recent decision. In 2004, the BFH held that the exchange of financial assets was not regarded as harmful for purposes of the change-in-ownership rule. However, under the new decision, this rationale should not apply generally to all exchanges of assets but should be limited to cases where one asset is exchanged for another asset which has the same function in the company's business.

Applied on a more general basis, this decision potentially creates uncertainty for determining whether an injection of predominantly new assets has taken place. It also likely will make the utilization of loss carryforwards even more difficult where the company's line of business is changed after the share transfer. With its latest decision on the change-in-ownership rule, the BFH confirms some of its statements in a highly disputed decision from August 2001, which have not been followed by the German tax authorities. It remains to be seen how the tax authorities will react.

The criterion of an "injection of predominantly new assets" for a two-year period after the change in ownership will only be relevant for direct share transfers that take (or took) place before 1 January 2008, because as from 2008, a direct or indirect transfer of more than 50%/more than 25% of the shares in a German company to one person will lead to a complete/pro-rata forfeiture of existing loss carryforwards (see GTLN Addendum 7/2007).

## **BFH rules on the tax treatment of corporate mergers**

The BFH recently rejected the tax authorities' position on the tax treatment of corporate mergers (see GTLN 2/2007) under the old Reorganization Tax Code. The court held that taxpayers may elect the tax valuation of assets transferred in a corporate merger independently from the German GAAP valuation. The decision does not come as a surprise, taking into account a number of tax court decisions, as well as a BFH decision on similar valuation questions in reorganizations under the old Reorganization Tax Code, which were decided in the taxpayer's favour.

The decision will only be relevant for mergers for which documents were filed before 13 December 2006, since the relevant rules were changed in the revised Reorganization Tax Act. Under current rules, it generally is possible to have a deviating German GAAP and tax treatment of reorganization measures without triggering negative German tax consequences.

## **Case on tax authority fees for tax rulings now pending**

As from 19 December 2006, the German tax authorities have been allowed to charge a fee for granting a tax ruling (see GTLN 11/2006). There has been considerable controversy about whether the fees charged can be justified either in principle and/or in amount, with the majority opinion being that there is insufficient constitutional justification for the fee. This discussion has gained new momentum by a lawsuit brought before the lower tax court of Baden-Württemberg (1 K 46/07). The lawsuit is a test case initiated by a German tax professor, who argues that the fee violates the German constitution. Further content of the lawsuit is currently not publicly available.

Taxpayers should file an appeal against any fee assessment for granting a tax ruling with reference to the pending court case in order to keep the fee assessment open. However, according to German procedural tax law, the tax authorities do not have a legal obligation to put the appeal on hold, because the case is only pending before a lower tax court. Thus, it is within the discretion of the relevant tax office to suspend the handling of the appeal until the case is finally decided. It is unlikely that a suspension of payment would be granted in this case.

## **Contribution of a single asset to a German limited liability company against shares and share premium to be carried out at fair market value**

In a recently published decision, the BFH decided that a contribution of assets against shares and share premium to a company had to be carried out at fair market value. The company that takes over the assets thus gets a step-up in basis and an increase of future depreciation. The case involved the transfer of real property, but no complete business unit, so that relief rules were not applicable.

The taxpayer argued that the entire contribution should be made at fair market value. According to the tax authorities, a step-up in basis was possible only for the proportion of the value that related to the issue of shares (and the takeover of liabilities); consideration was paid for the transfer of the real property only to this extent, so only this part of the transaction could be treated similar to a sale. On the other hand, the value attributed to the share premium account was considered to have taken place without consideration and was treated as a (constructive) capital contribution by the tax authorities. Special rules apply to such capital contributions, i.e. they must be at book value if the contributed asset was purchased or constructed less than three years before the contribution (as was the case here). The tax authorities therefore denied the additional depreciation on the value attributed to the share premium account. This rule applies for assets that are contributed from private property to a business property. This rule normally should not apply for business assets, although this is not uncontested.

The BFH disagreed with the tax authorities, holding that the contribution of the real estate and the building had to be considered as a single transaction and could not be split. The entire transaction had to be considered as having been carried out for consideration (similar to a sale) and, therefore, at full market value. The company was entitled to the full step-up depreciation.

## French SICAV is not eligible for benefits under Germany-France tax treaty

The tax court of Lower Saxony held in a recently published decision that a French stock corporation that is organized as a société d'investissement à capital variable (SICAV) is not eligible for treaty benefits under the Germany-France tax treaty. According to the residence article in the treaty, an entity is deemed to be resident in one of the contracting states if it is taxed as a resident taxpayer in that country. Since the SICAV is exempt from income tax under French tax law and, hence, is not subject to domestic taxation in France, the tax court held that it was not tax resident in France so that it was not eligible for treaty benefits. Even though the case involves an outbound situation in which a German stock corporation received dividends from a French SICAV in 1988 and 1989, the principles of the decision may also be relevant for inbound situations, e.g. in the area of dividend withholding tax. The court decision is final.

The court's arguments generally are not persuasive, nor are they in line with the majority view expressed in no. 8.2 of the commentary on Art. 4 para 1 of the OECD model convention, according to which residency is based on the liability to tax in one contracting state, even if this contracting state does not impose tax. However, it may be argued that the court's position can be justified based on the specific rules in the Germany-France treaty, which suggests that only the unit holders but not the SICAV itself are eligible for treaty benefits. It is questionable whether this view would also apply to other investment funds in situations where the relevant treaty does not include a similar provision.

## Legal News

### BGH modifies case law on legal concept of liability for destruction of existence of a company

In July 2007, the BGH ruled in the "TRIHOTEL" case that the legal concept of liability for destruction of the existence of a company (Existenzvernichtungshaftung) continues to be in force, but on a modified basis.

Existenzvernichtungshaftung, which is not specifically found in any statutory provision, was established by the BGH in September 2001 in the "Bremer Vulkan" case. In establishing the principle, the BGH created an autonomous concept of corporate law that supplements existing statutory provisions on the maintenance of capital. In its recent decision, the BGH stated that the Existenzvernichtungshaftung should no longer function as an autonomous concept of corporate law but instead will only be based on tort (wilful immoral damage). As a result, the following changes apply:

- Immoral and wilful damage: Whilst the requirement of immoral damage (i.e. divestment of assets to the disadvantage of the company and for the person's own benefit or that of another person leading to the insolvency of the company or to the loss of creditor's rights) implies little change to the previous situation, such damage now must be caused by wilful acts, with the burden of proof on the company and its insolvency administrator, respectively.
- External vs. internal liability: Whereas previously the liability of the shareholder was external, i.e. a shareholder liable under Existenzvernichtungshaftung was liable directly vis-à-vis the creditor, it now is an internal liability against the company. A creditor may therefore only make a claim against the company and may enforce its rights by way of attachment and remittal of the company's claim against its shareholder.
- Inclusion of foreign legal entities: Since Existenzvernichtungshaftung is now based on tort rather than corporate law, it will likely include foreign legal entities with their registered or administrative seat in Germany, and their shareholders.

- Cash pooling: It is likely that participation in a cash pooling system (in particular, upon application of new sections 30, et seq. of the Act on Limited Liability Companies which are scheduled to come into force in 2008) will not qualify as "immoral damage" and, thus, will also not constitute an Existenzvernichtungshaftung unless the cash pool leader itself lacks liquidity.

The recent modifications to the Existenzvernichtungshaftung concept have received positive responses to the extent they clarify the liability of the shareholder. However, there is also criticism about the scope of protection and enforceability of creditor's rights, so further case law clarifications are likely.

This article was supplied by Dr. Tim Luthra (tluthra@raupach-we.de), Raupach & Wollert Elmendorff Rechtsanwalts-gesellschaft mbH.

## Deloitte News

### IIR International Tax Seminar

From 26–30 November 2007, IIR Ltd. will be hosting an International Tax Seminar in London that addresses current tax practice and planning opportunities in the US, Germany, France and Italy, and provides an overview of European holdings and financing regimes. Practitioners of Deloitte Munich will give a presentation on 27 November on the key features of the German tax system, with an emphasis on corporate taxation and transfer pricing in Germany. To register, or for more information, please contact IIR Ltd. (registration@iir-conferences.co.uk or www.iir-conferences.com/ITS). For a discount for registrations through Deloitte, please contact Sarah Gietl (sgietl@deloitte.de).

### Deloitte VAT Seminars

Deloitte Germany will be hosting afternoon seminars focusing on current VAT developments, VAT implications of cross-border transactions and VAT-related tax audit experience in the following locations:

Aachen	18 October 2007
Dortmund	23 October 2007
Düsseldorf	9 October 2007
Freiburg	18 October 2007
Munich	11 October 2007
Siegen	25 October 2007
Stuttgart	24 October 2007

The seminar will be conducted in German. If you are interested in attending seminars in Freiburg, Munich or Stuttgart and would like to receive a detailed program, please contact Lolita Blankenstein (lblankenstein@deloitte.de). Please contact Susanne Sebald (ssebald@deloitte.de) for all other locations.

### Save the date: Deloitte year-end tax planning conference

In November and December 2007, Deloitte Germany will host its annual year-end tax planning conference in the following locations:

Berlin	29 November 2007
Bremen	20 November 2007
Düsseldorf	4 December 2007
Erfurt	4 December 2007
Frankfurt	20 November 2007
Hamburg	21 November 2007
Hannover	13 November 2007
Leipzig	27 November 2007
Munich	28 November 2007 (with specialist workshops)
Nuremberg	22 November 2007
Stuttgart	29 November 2007

Please note that the conference will be conducted in German.

The conference will focus on current German tax developments and the implications of potential tax law changes. If you are interested in attending or require more information, please contact Lolita Blankenstein (lblankenstein@deloitte.de).

## Phone conference – EC law aspects of current German tax developments

On 10 October 2007, at 3pm German time, the leader of the German EU tax group Otmar Thömmes, will host a conference call on current German tax developments and their EC law implications. The focus of the conference call will be EC law aspects of the new interest deduction limitation, the revised German anti-treaty shopping rule and the revised CFC legislation. Attending the teleconference will be free of charge. If you are interested in participating, please email [gfskntax@deloitte.de](mailto:gfskntax@deloitte.de). The conference will be held in German.

## Frankfurt Breakfast Series

Deloitte Frankfurt hosts regular breakfast meetings on international tax developments from EU, US and German perspectives. The next breakfast meeting will take place on 10 October 2007 in Deloitte's Frankfurt offices with a focus on FIN 48 reporting. If you are interested in attending, or would like to receive invitations for upcoming breakfast meetings, please contact Ebru Özüaydin ([eoetzueaydin@deloitte.de](mailto:eoetzueaydin@deloitte.de)). The upcoming breakfast meeting will be conducted in German.

## Deloitte European Tax Briefings

Deloitte currently hosts tax webcasts on current European tax developments. The tax briefings, which are free of charge, are designed to bring tax executives up to speed on European tax developments.

The upcoming tax briefings which will each take place at 8.30 am and 12.00 noon UK time will focus on the following topics:

21 November 2007 – Tax status of holding companies: a moving target!

30 January 2008 – A tour of Europe

26 March 2008 – OECD and international tax planning: friend or foe?

Please email [taxdeloitteeuropeanbriefing@deloitte.co.uk](mailto:taxdeloitteeuropeanbriefing@deloitte.co.uk) if you would like to attend the next Debriefs and/or would like to receive an agenda. The European Tax Briefings are held in English.

## Notice

If you are interested in regularly receiving this publication or if you know anyone else interested in receiving a copy, please send his/her information to the following email-address: [gtln@deloitte.de](mailto:gtln@deloitte.de)

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