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New German government puts tax reform on political agenda

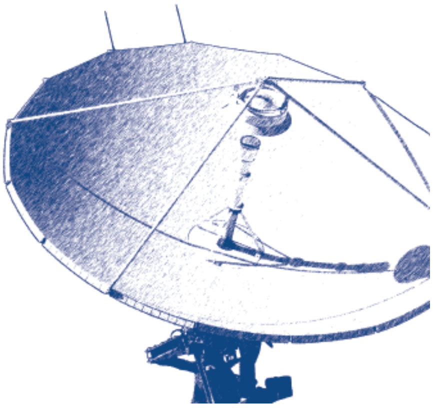
After the federal elections on 27 September 2009, the new German conservative/liberal coalition that will govern during the next four years published on 24 October 2009 its draft coalition agreement which is to be signed on 26 October 2009. The agreement, which describes the government's policy goals and how it intends to achieve those goals, includes some details on planned tax changes, which are likely to affect many taxpayers.

It should be noted that the draft agreement is a policy document rather than draft law, so taxpayers cannot rely on statements in the agreement. However, the announcements should be taken into account for planning purposes, e.g. when deciding whether to implement a particular structure in 2009 or in 2010.

The government intends to introduce legislation that would make the following changes **effective 1 January 2010**:

Change-in-ownership rule

- The recently introduced temporary exemption from the change-in-ownership rule for share transfers in the context of a qualifying financial restructuring ("Sanierung"), which had been limited to restructurings taking place in 2008 and 2009, would be extended beyond 2009 for an indefinite period of time.
- Exceptions to the change-in-ownership rule would apply for intragroup restructurings so that loss and interest carryforwards would not be forfeited in these transactions.
- Loss carryforwards would continue to be available after a share transfer to a third party to the extent of built-in-gains in the transferred business.



Interest deduction limitation rule (30% EBITDA limitation)

- The recently introduced temporary increase of the de minimis threshold to EUR 3 million of net interest expense for 2008 and 2009 would be extended beyond 2009 for an indefinite period of time.
- Retroactively as from 2007, a five-year EBITDA carryforward may be introduced; according to our understanding, if a taxpayer in Year 1 had net interest expense of less than 30% of tax EBITDA, the excess EBITDA could be used in Year 2 or later years when the net interest expenses exceeded 30% of current EBITDA.
- The equity ratio comparison test (i.e. the "escape clause", which allows companies not to apply the interest deduction limitation rule in certain situations) would be amended and made applicable to German multinational companies (presumably by facilitating the equity ratio comparison test for holding companies).

Real estate transfer tax
- An exception from real estate transfer tax (RETT) for intragroup restructurings would be introduced.

Transfer of functions
- The existing rules concerning a transfer of functions out of Germany (triggering full exit taxation) would be relaxed (although no details are provided on changes to the exit taxation rules).

Trade tax add-backs
- The current trade tax add-back of 16.25% of rental payments for immovable property would be reduced to 12.5%.
- Other trade tax add-backs would be reviewed by a working group on local taxes.

Amortization for low-value assets
- For low value assets, a choice between an immediate amortization for assets up to EUR 410 or amortization on a pool basis for all assets with a value between EUR 150 and EUR 1,000 would be introduced.

Other potential amendments
Several other amendments also are planned, such as changes to the administrative fees imposed to obtain a binding ruling (fees may be triggered only in complex and time-consuming cases), the introduction of a rule requiring tax audits to be completed within five years of the date they commence, changes to the inheritance and gift tax rules and changes to certain VAT rules.

In addition to these immediate action points, the new government has included the following in its **mid-term agenda** to be reviewed over the next four years:

- Introduction of a new system dealing with the utilization of loss carryforwards;
- Review of the current rules on the cross-border taxation of earnings within multinational companies (i.e. cross-border transfer of profits and losses);
- Introduction of a new group taxation system to replace the current "Organschaft" regime;
- Tax incentives for R&D activities (likely focusing on SMEs); and
- Review of possibilities to replace the trade tax on income by alternative financing sources for the municipalities.

While the coalition government remains committed to combating tax evasion through tax haven jurisdictions, the agreement states that there are no plans to change the current exemption system for profits generated outside Germany when negotiating Germany's double tax treaties.

As noted above, the draft coalition agreement is not legally binding on the parties, but only illustrates the political objectives of the new government. It remains to be seen how and when these political objectives will be introduced in the legislative process.

Notice

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