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German Tax and Legal News

"Green Book" on tax convergence published / German coalition parties announce further business tax reform

The French and German Ministries of Finance published a "Green Book" on 6 February 2012 that summarizes the current discussions on convergence between the French and German tax systems. Additionally, on 14 February 2012, the German coalition parties announced a "Twelve Points Plan" for further business tax reform, taking up some of the elements of the Green Book, but also introducing new proposals that are generally designed to address perceived loopholes. As a policy document, rather than a draft law, it is possible that the proposals ultimately may take a different form.

Background

In 2011, German Chancellor Merkel and French President Sarkozy politically agreed on taking steps towards a convergence between the French and the German business tax systems in an effort to respond to the daunting challenges created by the financial crisis. A working group of tax officials from both countries analyzed the French and German business tax systems and identified several key areas in which convergence of the tax systems would be recommended.

The Green Book outlines the current thinking on potential measures of convergence in the following areas:

- Group taxation;
- Taxation of dividends;
- Thin capitalization;
- Offsetting of losses;
- Depreciation and amortization;
- Taxation of partnerships; and
- Corporate income tax rates.

The French-German initiative aims to promote the harmonization of business tax matters in the EU and to support the Common Consolidated Corporate Tax Base (CCCTB) project, promoted by the European Commission to strengthen the economic integration in the EU. Several measures proposed in the Green Book may be implemented by 2013, so convergence clearly is high on the political agendas of France and Germany. Whether convergence will remain high on the agenda after the upcoming presidential elections in France, however, is uncertain.

From the summary of the key focus areas in the Green Book, it appears that more extensive changes can be expected in France than in Germany. A number of the proposed changes may lead to a broadening of the French tax base, and they may be combined with other amendments, such lowering the corporate income tax rate in France to ensure that the level of taxation is approximately the same in France and in Germany.

Potential changes for French taxpayers

The changes on the French side would impact acquisitions and reorganizations, as well as the general tax profile of operating companies across all industries.

Thin capitalization

Although France's thin capitalization rules have been amended several times since the 2006 reform, the Green Paper considers more changes. However, the ultimate shape of these amendments is not definitively set out and four options are envisaged. One option would align French rules with the current German interest deduction limitation rule, while the others would focus on a balance between exempt income and related nondeductible financing costs, or would harmonize and/or clarify the thin capitalization and anti-abuse regimes, including rules enacted in late 2011.

In all cases, in view of the significant impact anticipated for French companies, which are generally substantially more highly leveraged than their German counterparts, a more in-depth analysis will be needed to determine the required reduction of the corporate income tax rate to offset the additional tax costs of the new rules.

Depreciation and amortization

France may introduce the possibility to amortize goodwill recorded pursuant to an acquisition, but unlike the rules in Germany, this may include share purchases. It is not specified whether the useful life of such goodwill would be deemed to be 15 years, as is currently the case in Germany.

Amortization on a decreasing balance basis or exceptional amortization would no longer be available to align the French tax rules with German rules, except where required by economic circumstances, in order to fuel growth and foster investment.

Tax loss utilization

In view of the changes enacted in September 2011, the main outstanding difference between the utilization of tax losses in France and Germany is in the forfeiture rules, which are based on a change-of-activity in France as opposed to a change-of-ownership in Germany. Specifically, in Germany, losses may be forfeited to the extent there are direct or indirect changes in the ownership of the loss-making company that exceed certain thresholds (unless exceptions apply); under the French rules, loss carryforwards are disallowed in the case of a “thorough” change of business or activity of the loss company (irrespective of the ownership of that company).

The Green Paper does not provide any final recommendations, but would favor the use of objective criteria (such as revenue or assets impacted) to qualify for a change-of-activity, rather than a straightforward shift towards the German change-of-ownership principle.

Partnerships

The current French system, based on a semi-transparent nature of partnerships, gives rise to some significant issues, namely for participation exemption purposes for which French partnerships are not eligible, or when dealing with cross-border flows of revenue. Measures presented to Parliament in 2010, but rejected because of their complexity and unclear financial consequences would be revisited to achieve a fuller transparency as part of the convergence project to align French partnership rules with Germany’s rules.

Business tax

The portion of the French business tax based on value added (the *“contribution sur la valeur ajoutée des enterprises”)* would become nondeductible to align with the tax treatment of the German trade tax. The treatment of other aspects of the French business tax would remain unchanged.

Tax rate

The envisaged reforms would substantially broaden the tax base of French companies, which are already subject to a corporate income tax whose effective rate can be up to 6% higher than in Germany. Hence, the Green Paper recommends that the changes be combined with a corresponding decrease of the corporate income tax rate to maintain an even level of the tax burden for French companies and prevent a negative impact on competitiveness. The amount of the decrease is not disclosed, as it would be contingent on final positions taken on some of the issues left open by the Green Paper, but is expected to be significant in light of the reforms contemplated and their financial impact on a like-to-like basis.

Potential changes for German taxpayers

Key areas of changes for German taxpayers could include the following:

Group taxation

The Green Book and the Twelve Points Plan mainly reflect the ongoing domestic discussion on a reform of the tax consolidation (Organschaft) rules. In particular, the requirement for a profit and loss pooling agreement may be modified or eliminated, and the minimum holding requirement to create a consolidated group, currently set at a threshold of more than 50% of the voting rights, may be increased to 75% or even 95%. It appears that more extensive amendments are not contemplated; the Green Book specifically states that the implementation of a full consolidation system between group members (such as the French “intégration fiscal”) is not envisaged in Germany. The Twelve Points Plan states that a new tax group system in Germany would take effect as from 2016.

Taxation of dividends

A minimum ownership requirement to qualify for the 95% exemption of dividends at the level of a corporate shareholder is considered. The minimum ownership threshold could be up to 10%. This option could be considered a response to the 20 October 2011 decision of the European Court of Justice in which the court held that the German withholding tax on dividends paid to portfolio shareholders infringed EU law. Surprisingly, this potential change is not mentioned in the Twelve Points Plan, although this does not mean that a change is off the table.

Moreover, Germany intends to introduce an anti-hybrid rule, according to which all dividends may only enjoy the 95% exemption if they have not been treated as a deductible expense at the level of the paying entity.

Offsetting of losses
It appears that Germany intends to leave the rules on the utilization of losses largely unchanged. It is proposed, however, that the maximum loss carryback amount should be increased from EUR 511,500 to EUR 1 million, and that the carryback of losses becomes compulsory (rather than optional as is currently the case). Restrictive rules on the cross-border utilization of losses in the case of permanent establishments may be introduced. The Twelve Points Plan also includes a proposal that would disallow the offsetting of losses where a profitable company is merged into a loss company.

Taxation of partnerships
Germany does not intend to modify its rules on partnership taxation. In particular, an option for corporate taxation, as it is currently the case under French tax law, is not mentioned as a potential change.
A law change, however, would ensure that payments by a German partnership to its foreign partner would, in principle, remain subject to German tax.

Interest deductibility
The Twelve Points Plan includes a proposal that would disallow interest deductions that stem from a leveraged buyout and where the related debt is in effect funded from the income of the target company.

Outlook
The Green Book summarizes the current thinking of focus areas of the proposed convergence. With the release of the Twelve Points Plan, it appears that the German coalition parties will use the convergence project to amend areas of the law where a need for reform already has been identified. For France, convergence is seen as an opportunity to rethink the corporate income tax base and shift from a small base-high rate to a broad base-lower rate environment, while reviewing objectives assigned to some of the main tax instruments included in the French Tax Code.

If carried out as envisaged, the French-German convergence program will be a further step towards a harmonization of business tax systems by Europe and ultimately should help to promote the CCCTB. Convergence also likely will lead to increased cooperation between the tax authorities of the two countries.

If you have any questions please contact the authors of this article at gtln@deloitte.de or your regular Deloitte contact.