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German Tax and Legal News

First draft of business tax reform bill of the Ministry of Finance released

Draft bill includes inter alia amendments to the existing interest deduction limitation rules and introduction of a maximum interest barrier rule.

On 12 July 2023, a first draft of a business tax reform bill ("Growth Opportunity Act") of the German Ministry of Finance (MOF) was released. The draft bill aims to increase growth opportunities for the German economy, enable investments and innovation in new technologies, and strengthen the competitiveness of Germany as a business location. The measures included in the 275 pages of the draft bill (including legislative material) provide for simplification through increased thresholds and allowances and many smaller measures rather than a comprehensive or fundamental overhaul of the existing rules.

The draft bill includes proposed tax measures to increase the maximum annual amount of qualifying expenses for the research and development (R&D) tax incentive, increase the loss carryback period for individual and corporate taxpayers and make permanent the EUR 10 million maximum amount for loss carrybacks for corporate taxpayers, temporarily suspend the limitation of the offset of a net operating loss (NOL) carryforward against current year profits for purposes of the minimum taxation rules and increase the maximum amount of the carryforward, amend the interest deduction limitation rules, introduce a "maximum interest barrier rule," and introduce a mandatory disclosure and reporting requirement for certain domestic tax planning arrangements. The draft bill also explicitly refers to the fight against unwanted tax arrangements and measures that were already included in the original coalition agreement between the Social Democratic Party, Free Democratic Party, and Green Party from November 2021 (see GTLN dated 11/26/2021).

The most significant measures for businesses in the draft bill are the following:

- A climate investment grant was introduced in a maximum amount of EUR 30 million per qualifying applicant for the investment period (i.e., the date the law becomes effective until 1 January 2028). The grant would be structured as a cash grant and calculated based on 15% of the qualifying expenses for climate protection measures during the investment period with a maximum amount of EUR 200 million of qualifying expenses. Climate protection measures would include measures that increase the energy efficiency of the business operations of a company but would not include measures related to combined heat and power generation, long distance heating and cooling, and energy systems that are operated with fossil fuels (e.g., natural gas). Investments in real estate, intangible assets (e.g., intellectual property), and current assets would not be eligible investments.
- The existing R&D tax incentive would be broadened for new projects as from 2024. The maximum annual amount of qualifying expenses would be increased from the current amount of EUR 4 million to EUR 12 million, which would result in an increased maximum annual amount of the R&D tax incentive from the current amount of EUR 1 million to EUR 3 million based on an unchanged 25% allowance of qualifying expenses. The increase of the maximum amount of qualifying expenses from EUR 4 million to EUR 12 million would be permanent (unlike the current amount of EUR 4 million, which is applicable only until 30 June 2026, after which the original maximum amount of EUR 2 million applies).
- The loss carryback period for individual and corporate income tax purposes would be increased from the current two years to three years, and the maximum amount of EUR 10 million for a loss carryback for corporate taxpayers would become permanent (currently the maximum amount of EUR 10 million is limited to losses generated from 2020 to 2023, and after 2023 the maximum amount decreases to EUR 1 million again). No carryback of losses is permitted for local trade tax purposes.
- The minimum taxation rules limiting the offset of an NOL carryforward against current year profits would be suspended from 2024 to 2027. After 2027, the maximum amount of current year profits that can be offset against NOL

carryforwards without any limitation would be increased from the current EUR 1 million to EUR 10 million, and the 60% limitation for the offset of any remaining current year profits would be reinstated. The proposal would apply for both corporate income tax and trade tax purposes.

- The option for immediate expensing for newly acquired moveable assets for small and medium-sized companies (i.e., with annual profits not exceeding EUR 200,000) would be increased from 20% to 50% of the acquisition costs of qualifying assets. The increase would apply for assets that are acquired after 31 December 2023.
- For purposes of the interest deduction limitation rules:
  - The stand-alone clause and escape clause would be abolished as from 2024. Under the stand-alone clause, the general 30% EBITDA limitation does not apply to companies that are not part of a group. Under the escape clause, the interest deduction limitation rules do not apply where a German borrower's equity ratio does not fall short by more than 2% compared to the group's worldwide equity ratio. Based on the explanation provided by the MOF, the reason for abolishing these two exceptions is due to the noncompliance of these exceptions with the conditions described in Council Directive (EU) 2016/1164 (Anti-Tax Avoidance Directive).
  - The exception from the interest deduction limitation rules where annual net interest expense is less than EUR 3 million still would be available, but it would be modified in a way where it would no longer be a threshold with a cliff (i.e., once the EUR 3 million of annual net interest expense is met or exceeded, the full amount is subject to the 30% EBITDA limitation) but a true exception (i.e., the 30% EBITDA limitation would apply only to annual net interest expense that meets or exceeds EUR 3 million). The exception would not apply to the extent annual net interest expense was increased by the utilization of interest carryforwards. Furthermore, the EUR 3 million threshold would no longer apply on a separate per-entity basis but on a group basis where one person or persons acting in concert control various entities that are engaged in the same business ("de-fragmentation clause").
  - The definitions for interest expense and interest income would be broadened so that they are aligned with the requirements as provided in the Anti-Tax Avoidance Directive.
  - A newly introduced provision would provide an exemption for interest expense related to funding of long-term public infrastructure projects within the EU as allowed by the Anti-Tax Avoidance Directive.
  - The proposed changes to the interest deduction limitation rules would become effective as from 1 January 2024.
- A "maximum interest barrier rule" was introduced to further limit the amount of deductible interest expense in a newly introduced section 41 of the Income Tax Code. Under the proposed rule, interest expense paid to certain related parties would become nondeductible if it exceeds a certain maximum interest rate (a base rate as provided in section 247 of the Civil Code plus a 2% margin). As the current base rate in section 247 is 3.12%, this would result in a maximum rate of 5.12%. An exception would apply if a creditor and the ultimate group parent entity (in case of a group) provide evidence that a borrowing would have been possible only for an interest rate that exceeds the maximum interest rate as provided by the maximum interest barrier rule. An exception also would apply for a creditor that has sufficient substance and activities in its jurisdiction of residence but would not be available if the jurisdiction where the creditor is resident does not exchange information for tax purposes with Germany based on a qualifying provision in a double tax treaty or in a tax information exchange agreement with Germany. The maximum interest barrier rule would be effective as from 1 January 2024.
- Changes to certain rules for the taxation of partnerships and their individual partners were proposed that would reduce the individual income tax burden for reinvested earnings of the partnership. The proposed measures are aimed at aligning the tax burden for reinvested earnings of partnerships and corporations, since the existing mechanism to achieve this goal is not seen as being efficient enough. The draft bill proposes certain technical changes to the special tax rate for individuals for reinvested earnings with the intention to increase the attractiveness of this type of arrangement. For example, amounts used to pay the trade tax (paid at the partnership level) would automatically qualify as reinvested earnings and therefore trigger a reduced tax rate at the level of the partner who is an individual.
- In regard to the recently introduced option for a partnership to be taxed as a corporation, the draft bill would relax the deadlines for filing the election to be taxed as a corporation and provide certain technical clarifications about the tax consequences of such an election.

- A legal basis for participation in international voluntary risk assessment and assurance programs in section 89b of the General Tax Code was introduced. The proposal should increase legal certainty and provide additional details for participation in programs like the International Compliance Assurance Programme (ICAP), European Trust and Cooperation Approach (ETACA), and other similar projects.
- A mandatory disclosure and reporting requirement for certain purely domestic tax planning arrangements was introduced. The domestic reporting requirement would be similar to the cross-border reporting requirement under Council Directive (EU) 2018/822 (referred to as "DAC 6"). The hallmarks for domestic tax planning arrangements, however, would be adjusted and somewhat different from those as provided for under DAC 6. The domestic reporting requirement would apply to income taxes, property taxes, trade tax, inheritance and gift taxes, and real estate transfer tax. The domestic reporting requirement would apply only to users that fulfill certain criteria in terms of revenue/income, belong to a group in terms of the Stock Corporation Act, are controlled together with other domestic companies by foreign persons, or are investment funds or certain investors in specified investments. The domestic reporting requirement would apply for reportable transactions that are implemented after the law becomes effective. For reportable transactions that are implemented between the effective date of the law and 31 January 2025, the reporting would need to occur by 1 April 2025; otherwise, the reporting would need to occur within a two-month deadline.
- The tightening of the rules in section 15 of the Reorganization Tax Code (RTC) for tax-neutral demerger transactions was proposed. The proposal would reverse a taxpayer favorable decision of the federal tax court from 2021 and include the interpretation of the tax authorities in regard to the RTC. A tax-neutral demerger generally is not available if it qualifies as a sale to a third party or as a preparatory step for a sale to a third party. Under the current rules, there is an assumption that, if within a five-year period following the demerger date, shares in a company that was involved in the demerger transaction and that exceed 20% of the value of the shares in the company before the demerger transaction are sold, the original demerger transaction has been effected in preparation for a sale to a third party. If the 20% threshold is not reached, then a sale to a third party does not result in a (retroactive) denial of the tax neutrality of the demerger. Under the proposal, the 20% threshold would no longer be a mandatory threshold; as such, a sale below the 20% threshold could qualify as being harmful for purposes of the tax neutral character of the demerger. The proposal also includes a definition of a third party for purposes of the demerger provision. The amended rules would apply to demerger transactions for which the application for registration with the commercial register is filed after the date of the official publication of the law.
- A EUR 1,000 de-minimis threshold was introduced for earnings from rental activities of individuals in order to reduce the compliance burden for taxpayers and the tax administration.
- A publicly accessible electronic register for recipients that qualify for tax deductible donations with the federal tax office and a digital tax deduction mechanism for donors were introduced.
- An increase was proposed of the threshold to qualify for the submission of annual rather than quarterly VAT returns from EUR 1,000 to EUR 2,000.
- An obligation to issue an electronic invoice for the domestic supply of goods and services between two entrepreneurs for VAT purposes was introduced.

The draft bill must be approved by the government (which is planned for next month) before it can be introduced into the formal legislative process where it would require the consent of the upper and lower houses of parliament.

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