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German Tax and Legal News

Ministry of Finance publishes draft legislation to implement the EU Pillar Two Global Minimum Taxation Directive into domestic German tax law

Draft bill is in line with requirements as described in the EU directive, introduces qualified domestic minimum top-up tax (QDMTT).

On 20 March 2023, the German Ministry of Finance published draft legislation on the domestic implementation of the EU directive on ensuring a global minimum level of taxation for multinational enterprise (MNE) groups and large-scale domestic groups in the EU ("Pillar Two" directive). The draft legislation is open for public comments until 21 April 2023.

Summary

- Germany is among the first EU member states to publish draft legislation to implement into domestic law the Pillar Two directive. As expected, the draft legislation closely reflects the Pillar Two directive, which is based on the Pillar Two Model Rules ("Model Rules") of the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework). The Pillar Two directive contains certain adjustments from the Model Rules to ensure conformity with primary EU law (i.e., domestic groups also being in-scope).
- The draft legislation contains an income inclusion rule (IIR) (Primärergänzungssteuer), an undertaxed profits rule (UTPR) (Sekundärergänzungssteuer), and a qualified domestic minimum top-up tax (QDMTT) (nationale Ergänzungssteuer).
- The IIR and QDMTT are expected to apply for fiscal years starting after 30 December 2023. The UTPR is expected to apply for fiscal years starting after 30 December 2024.

Background

On 16 December 2022, the Council of the European Union issued a press release that confirmed the formal adoption by written procedure of certain pieces of legislation, including the Pillar Two directive. The adoption was the final step in the Council's legislative process for the legislation. The Pillar Two directive must be implemented into the EU member states' domestic laws by the end of 2023.

Pillar Two Model Rules

The Model Rules apply to MNE groups that have annual consolidated group revenue of EUR 750 million or more in at least two of the four fiscal years preceeding a "tested" fiscal year. Within the EU, domestic groups that meet this revenue threshold also are in-scope. The Model Rules provide rules for determining which entities are in-scope, (rather complex) rules on how to calculate global anti-base erosion (GloBE) income (using the accounting standard of the ultimate parent entity as a starting point), and rules to determine taxes the entities are subject to.

These determinations form the basis for the jurisdictional effective tax rate (ETR) calculation, which is comprised of the GloBE income of a group's entities within a jurisdiction divided by "covered taxes." If the ETR does not meet the agreed minimum rate of 15%, an additional tax is due to ensure the overall tax on the (excess) profits in all jurisdictions amounts to 15%. To assign this top-up tax, the Model Rules rely on two (if not three) different key components, which are set forth below.

The primary rule is the IIR, which bears some similarities to controlled foreign company rules, and applies on a top-down basis. In most cases, any top-up tax due must be calculated and paid by the ultimate parent entity to the tax authority in its jurisdiction. Jurisdictions that have a large number of MNE groups headquartered in their jurisdiction are expected to gain from this provision.

The secondary rule is the UTPR, which applies as a back-stop rule, meaning that any top-up

tax that could not be assigned via the IIR will be assigned to jurisdictions that have enacted the UTPR. The allocation of any "left-over" top-up tax is based on a formula (containing a fixed asset and employee allocation key) and will be implemented by jurisdictions either through a denial of deductions or an equivalent local adjustment.

A third element is the option for jurisdictions to adopt a QDMTT. This provision gives jurisdictions the possibility to raise the ETR of a group's entities within that jurisdiction to 15% before the IIR (and potentially the UTPR) applies to the profits. As a result, it would be the source jurisdiction and not the jurisdictions that apply the IIR or UTPR that collect the additional revenue resulting from the application of the GloBE rules.

German implementation of Pillar Two directive

As expected, the draft legislation closely follows the Pillar Two directive. Germany intends to introduce a QDMTT to ensure that low-taxed profits of German entities that are part of a group become subject to a German top-up tax, which would prevent other jurisdictions from taxing the undertaxed German profits. Taking into account the (approximately) 30% German tax rate, it is not expected that a German QDMTT will have a significant impact in this regard.

The draft legislation is set forth as a separate tax act ("Act to guarantee a global minimum tax for group companies") and would apply next to the existing tax laws (e.g., corporate income tax, trade tax, and the general tax code). The draft legislation consists of rules that are described over 78 pages (242 pages including legislative materials) and encompass 89 sections. The draft rules are a separate conceptual framework (largely following the structure of the Model Rules) with their own definitions and minimal interaction with other German tax laws. The draft rules would introduce numerous new technical terms and definitions into German tax law.

The draft legislation provides that the IIR and QDMTT would be applicable for fiscal years starting after 30 December 2023. The UTPR would be applicable for fiscal years starting after 30 December 2024. This is in line with the OECD timeframe and also with the timeframe as provided in the Pillar Two directive.

The draft legislation introduces a safe harbor for foreign qualified QDMTTs, which is in addition to the transitional safe harbors as described in the OECD safe harbor guidelines dated 20 December 2022. The most recent guidance from the OECD, which is dated 2 February 2023, is reflected insofar as controlled foreign company taxes would not be considered for the calculation of the German QDMTT.

The draft legislation follows the Pillar Two directive with regard to compliance requirements. An information return (see below) generally would be required to be filed 15 months after the end of the fiscal year, with the tax return due at the same time. For both, an 18-month period would apply for the first fiscal year. For the filing of the tax return, the provisions of the general tax code would be applicable. The tax would be required to be self-assessed and due, at the latest, one month after the tax return is filed.

German entities part of a group would be required to file an information return disclosing extensive group information (e.g., detailed group structure, qualifications of entities, ETR per jurisdiction, application of IIR and UTPR, etc.) in the event no information is exchanged with the ultimate parent entity's jurisdiction. Although it is expected that Inclusive Framework jurisdictions will exchange such information, a phased implementation could mean that groups are not fully covered immediately. This could result in separate filing obligations for such German entities.

The transitional rules prescribed by the EU directive and Model Rules are included in the draft legislation. This means, among other things, that intragroup asset transfers that take place between 30 November 2021 and the first fiscal year in which entities are subject to the legislation could be impacted by the rules.

Outlook

Comments to the draft legislation may be submitted until 21 April 2023. It is expected that the draft legislation will be approved by the government shortly afterwards, and then officially introduced into the legislative process so that the rules can be finalized and be approved by the upper and lower houses of parliament prior to the end of 2023.

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