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German Tax and Legal News

New government publishes draft coalition agreement including broad tax policy goals

High-level agenda includes expected tax policy objectives and some surprises; tax rises are no longer explicitly excluded.

The "traffic-light" coalition between Germany's Social Democratic Party (SPD), the Free Democratic Party (FDP), and the Green Party successfully finalized its negotiations and released its draft coalition agreement on 24 November 2021. The 177-page draft agreement sets out the future government's policy goals, including those relating to tax policy, and how it intends to achieve these objectives.

As a result of the German federal elections on 26 September 2021, Angela Merkel's Christian Democratic Union (CDU) lost its position as the country's leading political party to the SPD, the CDU's current partner in the governing grand coalition. The SPD, the FDP, and the Green Party formally agreed on 15 October 2021 to enter into coalition negotiations to form a new German government.

The draft coalition agreement outlines the measures that the future government proposes to take. Although there are few details on concrete tax measures, the draft agreement offers some insight into what can be expected. The draft agreement does not specifically mention any major tax reform projects or changes in tax rates — the focus will be on the digitization and debureaucratization of the tax system and measures to combat tax evasion and harmful tax practices.

The draft agreement has still to be confirmed by all three political parties, although the content is not expected to change. The SPD and FDP will hold party conventions over the weekend of 4 and 5 December 2021 to approve the agreement, while the Green Party will hold a referendum of party members that is intended to close on 4 December 2021.

The draft coalition agreement includes well known tax principles as previously mentioned in the initial policy paper of the three coalition parties published on 15 October 2021 (see GTLN, 19 October 2021) together with some new tax policy goals, but also is silent on certain issues of tax policy included in the preliminary agreement.

Key tax policy statements
The most significant tax policy statements for businesses in the draft coalition agreement are as follows:

- A "super deduction" (seemingly in the form of accelerated depreciation) should be introduced for investments in climate protection and in digitization. Qualifying investments in specified fixed assets should be deductible at an increased rate during 2022 and 2023.
- The loss carryback provisions should be enhanced. The increased amount available to be carried back for corporate income tax purposes (EUR 10 million for losses incurred in 2021 and 2022) should be retained for losses incurred during 2023 and the loss carryback period should be extended to the two preceding financial years (under current rules, losses only may be carried back for one year). There seems to be an error in the coalition agreement which refers to the extension of the "loss carry-forward" to the preceding two financial years. No carryback of losses is permitted for local trade tax purposes.
- The newly introduced "check-the box" election for partnerships and the existing preferential tax treatment for accumulated/reinvested partnership profits should be evaluated to assess whether changes are required to make these rules more attractive.
- The federal states should be granted more flexibility to introduce measures to facilitate the acquisition of owner-occupied residential property. To finance this measure, real estate transfer tax (RETT) loopholes for corporate investors should be closed (the draft agreement refers to "share deals" without providing any additional

explanation).
- Mandatory disclosure and reporting requirements should be introduced for purely domestic tax planning arrangements for businesses with a turnover of more than EUR 10 million.
- Payments made to foreign recipients should be appropriately taxed at the level of the recipient; both nontaxation and double taxation of such payments should be averted. In order to achieve this goal, source-based taxation in the form of withholding taxes should be extended (by amending double tax treaties). The current interest deduction limitation rule (based on 30% of taxable earnings before net interest expense, tax, regular depreciation, and amortization (tax EBITDA)) should be supplemented by a "maximum interest barrier rule" to prevent harmful tax planning. The coalition agreement does not include any further detail regarding this additional limitation.

<u>Other tax policy objectives include</u>:

- Measures and subsidies that are unnecessary, ineffective, or damaging to the climate and the environment should be eliminated from the federal budget.
- The tax system should be simplified for both individuals and businesses. To achieve this, the future government intends to accelerate digitization and debureaucratization. For example, (i) prepopulated tax returns for individuals should be introduced, (ii) digital communication with the tax authorities should be possible, (iii) tax bureaucracy should be reduced by introducing, e.g., certain higher thresholds and digitized filing procedures, and (iv) certain tax rules for not-for-profit organizations should be simplified and become less restrictive.
- Combatting tax evasion and harmful tax practices will be an area of focus.
- The import VAT system at a European level should be further developed.
- A new governmental tax research institute should be introduced to assess and evaluate various types of data to identify tax evasion and harmful tax practices. The analysis should be used to initiate an evidence-based legislative process.
- VAT fraud should be combatted more effectively by introducing a new electronic registration system for invoices ("e-invoicing").
- The role of the federal tax office should be broadened, and tax audits should be modernized and accelerated.
- The future government would continue to support the introduction of a global minimum tax.
- The EU list of noncooperative jurisdictions for tax purposes (referred to as the "black list") should continuously be updated.
- The customs authorities should be modernized and digitized to combat financial crime and illegal employment more effectively. New technologies, such as blockchain, should be introduced in order to prevent abusive dividend arbitrage transactions ("cum-ex transactions").

Once the parties have formally signed the coalition agreement, the current Minister of Finance, Olaf Scholz (SPD) will be elected as the next German chancellor. It is currently expected that Christian Lindner (FDP) will become the next minister of finance.

Comment
It is notable that the initial policy paper published by the three parties in October 2021 included the specific statement "the parties do not intend to introduce any new taxes on assets, or to increase income taxes, corporate taxes, or VAT" but no such statement is included in the draft coalition agreement. The absence of such a commitment might indicate that the more pro-business FDP was not able to persuade its coalition partners to keep this statement in the agreement and that the upcoming government wishes to retain flexibility to potentially raise taxes or introduce new taxes in the future.

It currently is unclear how the RETT rules would be tightened further and what the references to loopholes and share deals in this context mean. Amended RETT rules were introduced as from 1 July 2021 based on exactly this rationale and taxpayers should monitor further developments closely.

The features of the "maximum interest barrier rule" are unclear. It remains to be seen whether this refers to the financing principles described in the German transfer pricing guidelines issued by the Ministry of Finance on 14 July 2021 (see GTLN, 29 July 2021) or to an additional limitation rule similar to the proposed new section 163(n) to the Internal Revenue Code included in the Build Back Better Act in the US (broadly designed to limit interest deductions for a domestic company that is a member of an international group having regard to the company's allocable share of the group's net interest expense).

A mandatory disclosure and reporting requirement for purely domestic tax planning arrangements was included in an unofficial draft of a law to implement Council Directive (EU) 2018/822 (commonly referred to as DAC 6) into German domestic legislation in January 2019 but did not make it into the legislative process (see GTLN, 2 October 2019). It remains to be seen whether the new government intends simply to revive the original 2019 draft or adopt an entirely new approach.

The coalition agreement is a policy document, rather than draft law. While taxpayers should not rely on the statements in the agreement, they should take the announcements into consideration and monitor future developments closely.

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