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German Tax and Legal News

Upper house of parliament approves business tax reform bill

Approved bill includes tightened transfer pricing rules for cross-border financing arrangements and other tax changes for businesses.

The upper house of the German parliament on 22 March 2024 approved the business tax reform bill ("Growth Opportunity Act"), which includes amendments to the transfer pricing rules for cross-border financing arrangements and to the minimum taxation rules regarding the use of net operating loss (NOL) carryforwards. The original bill had been approved by the lower house of parliament on 17 November 2023 (see GTLN dated 11/22/23) but later was rejected by the upper house of parliament on 24 November 2023 (see GTLN dated 11/27/23). The bill then was sent to the conference committee of the upper and lower houses of parliament for further negotiations (see GTLN dated 12/18/23). The conference committee approved an updated bill on 21 February 2024, which then was approved by the lower house of parliament on 23 February and now by the upper house of parliament. The bill is now heading to the president for signature and publication in the federal gazette.

Certain technical amendments with regard to the interest deduction limitation rules and real estate transfer tax (RETT), which were part of the original business tax reform bill, were already approved in December 2023 by both houses of parliament as part of an omnibus bill ("Secondary Credit Market Promotion Act").

The aim of the Growth Opportunity Act is to introduce additional tax incentives in order to strengthen the competitiveness of Germany as a business location. The final version of the bill should provide for tax relief for taxpayers of approximately EUR 3.2 billion.

The most notable tax measures introduced by the Growth Opportunity Act are set forth below.

Amendments to transfer pricing rules for cross-border financing arrangements
Instead of the originally planned introduction of a "maximum interest barrier rule," the approved version of the bill now includes amended and tightened transfer pricing rules for cross-border financing arrangements under the Foreign Tax Act. The rules include a three-prong test based on the arm's length principle:

- Debt capacity test: The taxpayer must provide plausible evidence as to the ability of the taxpayer to service the debt (both interest and principal) during the entire term of the debt;
- Business purpose test: The taxpayer must provide plausible evidence as to the taxpayer's need for financing and the business purpose for the loan; and
- Maximum interest rate test: The interest rate generally must be established based on refinancing conditions that would apply to an unrelated third party and must be based on the credit rating for the entire multinational enterprise group. An escape clause allows the taxpayer to argue that, based on the relevant facts, an interest rate higher than the one based on the group's credit rating could be at arm's length (a derivative group credit rating).

The intercompany provision of financing services, back-to-back financing arrangements, and treasury functions generally are deemed to be low-function risk services for purposes of the arm's length principle and for calculating an arm's length remuneration. The taxpayer may prove the contrary, i.e., that a higher remuneration would be justified based on the taxpayer actually bearing a higher risk.

The amended rules are not limited to situations where the lender does not have sufficient substance and activities, which was originally proposed as part of the maximum interest barrier rule. The amended rules are limited to cross-border financing arrangements and do not affect purely domestic financing arrangements. The amended rules are effective as from fiscal year 2024.

Amendments to minimum taxation rules regarding use of NOL carryforwards

The minimum taxation rules limiting the offset of NOL carryforwards against current year profits has been relaxed for the period 2024 to 2027. During this period, a taxpayer is allowed to offset 70% (up from 60%) of current year income exceeding EUR 1 million against NOL carryforwards. After 2027, the 60% limitation for the offset of any remaining current year profits will be reinstated. The amended rules apply for individual and corporate income tax purposes only (i.e., there are no changes for local trade tax purposes, i.e., the 60% limitation applies for local trade tax purposes).

Other notable tax measures

- Changes to certain rules for the taxation of partnerships and their individual partners are effective as from 2024 and not as from 2025 as originally proposed.
- The approved bill includes the (re-)introduction of a declining balance depreciation for moveable assets that are acquired between 1 April 2024 and 1 January 2025 (this had been temporarily introduced in the past as a COVID-19 support measure). The maximum amount of the declining balance depreciation is limited to twice the applicable straight line depreciation rate, with a maximum of 20% annually.
- In addition, a declining balance depreciation for residential buildings within the EU/EEA acquired or built between 1 October 2023 and 30 September 2029 has been introduced. The applicable annual depreciation rate for the declining balance depreciation for real estate is 5%.
- The cost basis for calculating the R&D tax incentive is going to be increased from currently EUR 4 million to EUR 10 million without any time limitation (originally an increase to EUR 12 million was proposed), the portion of eligible costs for contract research is going to increase from 60% to 70%. For small and medium-sized companies, a 10% increase of the R&D tax incentive is going to be available (i.e., 35% of qualifying expenses instead of the general 25% rate). The updated R&D tax incentive is going to become available starting from the day of the promulgation of the bill.
- The rules in section 15 of the Reorganization Tax Code (RTC) for tax-neutral demerger transactions have been updated and tightened. Indirect share transfers in one of the companies that is involved in the demerger transaction to a third party now explicitly qualifies as a harmful transaction for purposes of the tax-neutral demerger. The amended section 15 RTC becomes applicable for transactions where the required application with the commercial register is filed after 14 July 2023.
- The dual consolidated loss rules for tax consolidated groups (section 14 (1) number 5 of the Corporate Income Tax Code) has been abolished with effect as from 2024. The cancellation of the highly controversial rules is a reaction to the introduction of the general anti-hybrid rules/double deduction rule in section 4k of the Income Tax Code as from 1 January 2020.
- The transition period for the introduction of mandatory electronic invoicing for VAT purposes is two years (1 January 2025 through 31 December 2026) for business-to-business transactions and three years (1 January 2025 through 31 December 2027) for small companies (i.e., companies with revenue of up to EUR 800,000 in the preceding fiscal year). The general starting date for the introduction of mandatory electronic invoicing is 1 January 2025.

Measures not included in final version
Notable measures that were included in the original version of the Growth Opportunity Act that did not make it into the final version of the bill:

- The originally proposed climate investment grant in a maximum amount of EUR 30 million per qualifying applicant for the investment period (i.e., 2023 through 2027) did not make it into the final version. The original proposal included a cash grant 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. The financing of the climate investment grant could no longer be secured after a 15 November 2023 decision of the federal constitutional court ruled that a EUR 60 billion reallocation of unused debt unlocked during the COVID-19 pandemic by the federal government violated constitutional principles.
- The increase of the loss carryback period for individual and corporate income tax purposes from the current two-year period to three years and the increased maximum amount of EUR 10 million for a loss carryback for corporate taxpayers did not make it into the final version.
- The planned introduction of a “maximum interest barrier rule” (as previously mentioned) and a “de-fragmentation rule” was taken out of the bill in December 2023.

- The highly criticized plan to introduce mandatory disclosure and reporting requirement for certain purely domestic tax planning arrangements as set forth in the original draft bill was taken out and did not make it into the final version.
- The introduction of a tax-free allowance for income from rental activities in an amount of EUR 1,000 did not make it into the final version.
- The increase of the amount for qualifying low-value assets for immediate expensing from EUR 800 to EUR 1,000 did not make it into the final version.

Comments

The approved version of the bill is a result of the budget pressure facing the current government. As compared to the original tax relief for taxpayers of approximately EUR 7 billion, the approved version now has approximately EUR 3.2 billion of such tax relief. Whether the measures are significant enough to provide for sizeable tax relief for businesses and to initiate growth remains to be seen. The government already has announced additional proposed initiatives aimed to reduce the tax burden for businesses.

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