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Germany publishes draft ATAD implementation law

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On 11 December 2019, the first draft of the German "Law implementing the EU Anti-Tax Avoidance-Directive" ("Draft Law"; Council Directives 2016/1164 of 12 July 2016, and 2017/952 of 29 May 2017, "ATAD I and II") was released for public consultation. The further legislative process is expected to take place very quickly; Government approval of the bill is already expected for the week of 16 December. The Draft Law includes significant changes to the German taxation of cross-border transactions which partly go beyond those mandated by the European Union (EU) directives. Most of the measures will be applicable from 1 January 2020 onwards.

The Draft Law includes proposed changes in particular in the following areas:

- Anti-hybrid rules
- Cross-border Intercompany financing
- Taxation of cross-border asset transfers/exit taxation
- Controlled foreign corporation (CFC) rules
- General transfer pricing
- Advance pricing agreements
- Exit taxation for individuals

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Executive Summary

Overview of the proposed changes

- The wording of the anti-hybrid rules is very broad and general and not an exact technical rendition of the ATAD definitions, even though it broadly follows the ATAD framework. Deductions are generally denied for payments on hybrid financial instruments, made by hybrid entities or to reverse hybrids. In addition, deductions are denied for payments which are deductible in Germany and any other jurisdiction (double deduction), that is, no hybrid element is required for this disallowance. Moreover, imported mismatches are covered and not subject to any safe harbor rules.
- With respect to cross-border intercompany financing, the proposed changes of transfer pricing statutes are aimed at disallowing an interest deduction of a German taxpayer engaging in a cross-border related-party financing, if the taxpayer cannot demonstrate that: (i) principal and interest payments can be serviced throughout the entire term of the financing period; (ii) there was a business need for the financing; and (iii) the borrowed funds were utilized for that purpose (e.g., were not transferred to a cash-pool). In essence, this introduces an "allowable purpose" test for the financing. In addition, the acceptable interest margin for a foreign financing company (and any other "intermediary" in an intercompany "financial relationship") is effectively limited to the current market return of government bonds with "highest" rating/solvency and corresponding maturity (which may be zero or even negative in Europe at the moment). It is currently unclear, to what extent that rule would apply if a loan was granted by an equity financed intercompany lender.
- The Draft Law follows the principles mandated by the ATAD for the exit tax rules and now allows a deferral for asset transfers out of a German permanent establishment (PE) to the EU/European Economic Area (EEA) headquarter of the taxpayer. For transfers into Germany, the newly introduced correspondence requirement for tax valuations would deny the possibility to have mismatches in the asset valuation/taxation between the country of origin and Germany. Moreover, a transfer of an asset from a foreign (not treaty exempt) PE to the German headquarters would in principle lead to a taxable gain in Germany (and potentially also in the foreign jurisdiction) but a tax credit mechanism applies.
- Unfortunately, the proposed changes to the German CFC rules do not include a decrease of the current effective tax rate of 25% required for the so called "high-tax kick-out" or a tax credit mechanism for Trade Tax purposes. Moreover, the Draft Law would extend the application of the German CFC rules significantly. Currently, these rules are only applicable if the foreign corporation is controlled by German shareholders, i.e., if German shareholders own more than 50% of the shares or voting rights in the foreign corporation. According to the Draft Law, shares directly or indirectly owned by parties related to a German shareholder would have to be considered for this determination. For multinational groups, this effectively means that any direct or indirect participation of a German group entity in another, non-German group entity would result in "deemed" control over the CFC by German shareholders and, thus, make the German CFC rules applicable. In addition, CFC taxation is now imposed on non-German controlling shareholders owning shares in CFCs which are allocable to a German PE or through a partnership which creates a German PE. Besides this, the draft suggests several changes to the definitions of active income. Most importantly, dividends from portfolio investments (ownership below 10% as of the beginning of the calendar year) no longer qualify as active income and could, therefore, potentially be subject to a CFC pick-up now. On the other hand, the Draft Law defines capital gains from the sale of shares generally as active income and eliminates the additional active income testing elements. The same applies to income triggered in the course of foreign qualifying reorganizations between CFCs. In addition to these changes, the timing of a CFC pick-up is amended by the draft to occur at the end of the fiscal year of the CFC.
- Besides the already mentioned changes concerning cross-border intercompany financing, the Draft Law includes further significant changes to the German interpretation of the arm's-length standard and German transfer pricing (TP) documentation rules. It aims to update the German TP rules to appropriately reflect recent international developments (mainly the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) initiative). Among other items, the suggested changes relate to the definition of "affiliated entities," clarifications on applicable methods to determine transfer prices and details regarding the actual calculation

of transfer prices. It also anchors the DEMPE (development, enhancement, maintenance, protection and exploitation of intangibles) concept in German law.

- The Draft Law also introduces a basis for advance pricing agreements (APAs) into domestic law and provides for a corresponding procedure. Currently, APAs were solely based on applicable treaties. Most notably, taxpayers would have the ability to apply for an APA not only in the context of transfer pricing (i.e., double taxation arising from article 7 or 9 of the OECD Model Tax Treaty), but rather for all cross-border transactions, if the Double Tax Treaty (DTT) concluded between the countries includes a Mutual Agreement Procedure Clause similar to article 25 of the OECD Model Tax Treaty.
- The suggested changes regarding the exit taxation for individuals is, essentially, a reaction to recent decisions of the European Court of Justice (ECJ). The new rules proposed by the German Ministry of Finance do not differentiate between transferring the tax residence to an EU Member State or a third country. Currently, an exit tax deferral was granted for tax residence transfers to Member States until the individual has sold the shareholdings and triggered the capital gain. In accordance with the Draft Law, a deferral would now be granted in all cases but would require the payment of the tax in equal installments over a period of seven years.

Detailed Discussion

Anti-hybrid rules

Germany already has a wide range of rules that are intended to counter undesired tax outcomes due to the mismatch of rules in an international context. Most of the existing rules however deal with German-outbound situations only; there are as yet only limited rules that tie the tax treatment of intra-group expenses to the tax treatment at the recipient level (a significant exception being the royalty limitation rule, which since 2018 partially or wholly denies royalty deductions to non-OECD-compliant preferential tax regimes).

This would change with the now proposed introduction of a far-reaching general anti-hybrid rule. The draft rule is broadly based on the OECD Action 2 proposal and the ATAD I and II wording. It notably does not cover cases where the foreign non- or low taxation is not triggered by a hybrid mismatch, but due to the general rules applied in the recipient jurisdiction. Hence, the proposed rule would cover the German deductibility of expenses in the following situations:

- Financing transactions where due to a mismatch of either instrument qualification or asset attribution the income is subject to no or lower taxation at the recipient level than without the mismatch (e.g., hybrid loans/equity instruments; certain stock lending- or REPO-transactions). If the non- or low taxation at the recipient level is just temporary and the transaction is structured at arm's length, the rule does not apply.
- Any deduction/no inclusion scenarios, where the absence of an inclusion as taxable income is due to a mismatch in the qualification of the paying entity (e.g., disregarded transaction under United States (US) entity classification principles). This rule is not limited to financing transactions, but also covers any other payments which are in principle deductible (immediately or over time, e.g., by way of amortization); it also covers "dealings" between a PE and the relevant headquarters. An exception is granted where there also is dual inclusion income at the level of the foreign recipient, and thus the income is effectively taxed despite the mismatch (although a credit of underlying tax would in this case be harmful). The inclusion of the income due to an "equivalent" CFC income imputation would count as effective taxation and thus would turn off the anti-hybrid rule, although it is unclear whether the US Global Intangible Low-Taxed Income (GILTI) inclusion and other CFC regimes, which only impute a portion of the amount paid by the German taxpayer would count as "equivalent" CFC income imputation.
- Any deduction/no inclusion scenario, where the absence of an inclusion as taxable income is due to a mismatch in the qualification of the recipient entity (reverse hybrid; transparent under local law, but non-transparent from owner's perspective) or a branch income inclusion mismatch.
- Any double deduction scenario, e.g., due to a reverse hybrid entity (non-transparent locally, transparent at owner level), unless coupled with the double inclusion of (positive) income; an exception applies if the taxpayer demonstrates that due to the application of a foreign anti-hybrid rule at the parent or grandparent (though not at subsidiary) level, there is no effective double deduction.
- Imported mismatch scenarios, i.e., scenarios, where there is no mismatch at the level of the direct recipient of the expense, but where there is a mismatch in income taxation at any level other than the direct expense recipient, which is directly or indirectly resulting from the expense (e.g., due to a back-to-back structure). This rule would not apply

if the taxpayer demonstrates that due to the application of a foreign anti-hybrid rule at any direct or indirect recipient level, there is no effective mismatch.

In all of these cases, the German deduction is wholly denied (in the case of financing transactions, potentially only partly, if the mismatch only results in "lower" taxation, but not in a non-taxation). The rule applies to all related-party transactions (including persons acting in concert) as well as "dealings" between headquarters and PEs and also to structured arrangements involving third parties, where it is apparent from the contractual documentation or otherwise that a tax advantage resulting from a mismatch was intended. Only where it is reasonable to assume that a taxpayer which is party to an arrangement with a third party was not aware of any tax mismatch advantages and the taxpayer can demonstrate that he/she actually did not benefit from the tax mismatch, no structured arrangement would be assumed.

The new anti-hybrid rule would apply for all expenses incurred after 31 December 2019.

To address potential hybrid PE mismatches, there is also a proposal to not grant to German taxpayers a treaty-based PE income exemption to the extent that non-taxation would arise due to assumed dealings or a PE income exemption applied by the source/PE country.

Financial transactions

Considering that currently no consensus at the OECD level can be reached on how to price intercompany financial transactions, Germany issues its own view on how to deal with certain key controversial aspects in this area that have been subject to intense discussions and court decisions in the last few months and over the years. As such, this area of changes increases the likelihood of international disputes.

The Draft Law would implement a separate provision on financial intercompany transactions according to which interest expenses for an intercompany cross-border financing relationship (defined as in particular loans as well as the use or provision of debt or debt-like instruments) can only be deducted if the taxpayer can, cumulatively, demonstrate that:

i. It is likely at the time the funds were granted that funds including interest expenses can be repaid and serviced during the whole term of the financing relationship (debt capacity test);
ii. The financing is economically required;
iii. It serves the company's business purpose (business purpose test); and
iv. The interest rate for the cross-border intercompany financing relationship transaction does not exceed the interest rate at which the group refinances itself via third parties unless extraordinary circumstances can be proven.

Even though the reference to the group's interest rate generally appears similar to a "safe harbor interest rate," provided that the additional requirements are met, it has to be understood as a limitation of the acceptable interest rate. The explanatory notes provided with the draft stipulate that the German entity's stand-alone rating would be decisive if it should be better than the group's overall rating.

If these requirements cannot be demonstrated by the taxpayer, the interest deduction is generally denied in full.

Further, there is a specific rule established to deal with pass-through loans that is also relevant to financing companies as well as cash pool leaders and cash pool members.

In the case that financial transactions are conveyed, passed-through or mediated in any way, such service is considered per se a low-value-adding activity according to the Draft Law. This is applicable to captive treasury centers and captive financing companies performing, e.g., liquidity management, financial risk management for other group companies. It is even noted that the remuneration for such transactions should be limited notwithstanding any double tax treaty to a risk-free interest rate. Such risk-free rate is defined as government bonds of highest creditworthiness and with similar terms. As such for bonds with currently mostly negative yields,[1] the law prescribes a negative remuneration. Further aspects of the actual application of this new rule are quite unclear, e.g., the aspect of whether the risk-free interest rate should effectively be applied on the loan itself in the case of a fully equity funded financing company. There are reasons to believe that this should not be the case, but the current Draft Law does not describe this with certainty. It could also be questionable if such an extensive interpretation of the law would be in accordance with vested EU principles such as the freedom of movement of capital doctrine.

The impact of these proposed legislative changes on existing intercompany financial transactions is currently unclear. The fact that the German Government is drafting this as new law suggests that the current rules do not allow the described adjustments and interpretations. From this perspective existing arrangements may rely on the interpretation of the current law and tax court decisions. However, whether this view will prevail is unclear and most likely controversial. Historically, there are precedents where German tax authorities have interpreted legislative changes to TP rules as mere clarification of the existing arm's-length principle and have tried to apply new laws retroactively.

The impact of these new rules cannot be underestimated. They will have a substantial impact not only on German taxpayers but also the international bodies addressing how to deal with the TP aspects going forward, generally.

Taxation of cross-border asset transfers/exit taxation

The ATAD Directive requires EU Member States to allow a deferred payment of any tax relating to a deemed gain from an exit event (e.g., the transfer of assets from a German PE to a foreign (EU) headquarters or the transfer of an asset from a German headquarters to an EU PE). The deferral would be granted through a payment of the tax in five equal, annual installments, subject to certain security and holding conditions. In addition, the ATAD Directive stipulates that Member States should introduce corresponding valuation rules for assets which are transferred cross-border, so that the receiving country would be bound to step up the tax basis of the transferred asset to the value which had been underlying an exit taxation at the level of the transferor country.

The Draft Law follows the principles mandated by the ATAD. This leads to several significant changes compared to the current legal situation:

- While an exit tax deferral was already granted for asset transfers to EU/EEA PEs of German taxpayers, the deferral will now also have to be granted for transfers from German PEs to EU/EEA headquarters.
- Under current law, any asset transferred to a German business from a foreign PE is in principle stepped up to fair market value for tax purposes, irrespective of the foreign tax treatment and valuation. The newly required correspondence of tax valuations would deny the possibility to have mismatches in the asset valuation/taxation upon a cross-border transfer.
- For German-headquartered taxpayers with foreign PEs in jurisdictions for which the tax credit system applies (i.e., no exemption PEs), a transfer of an asset from the PE to the German headquarters would in principle lead to a taxable gain in Germany (and potentially also in the foreign jurisdiction), with a credit of the foreign exit tax being granted by Germany. Again, a valuation correspondence would apply.

CFC rules

The Ministry of Finance took the position that the German CFC rules are generally in line with the ATAD requirements, so only a few but material changes were proposed by the draft.

The current "high tax kick out" rate for German CFC income is 25%. For quite some time now, the German Government was confronted with taxpayer demands to lower that threshold, since now in many significant foreign jurisdictions, including the US, the effective ordinary corporate tax rates are or may be below that level. The hope was thus, that Germany would, in the course of the ATAD adaption, also lower the CFC income pick up threshold to a tax rate of 15%, or at least 20%, or alternatively allow a credit of foreign taxes on CFC income against the German Trade Tax (a second German business income tax with an average rate of 14%). However, none of those expectations materialized, and the draft law neither includes a rate drop, nor a tax credit for Trade Tax.

First, the law introduces, in line with ATAD I, a broader control concept (control is defined as the majority of a direct or an indirect participation in the voting rights, capital or profits of the foreign company). Now, ownership interests of foreign related parties are also considered when determining whether a German taxpayer controls a foreign company. In principle, this can result in CFC taxation, even if the German taxpayer owns only a small interest in a foreign subsidiary (Example: US parent owns 100% of German company B. B owns 5% in foreign company C, A owns the remainder 95% in C – B would be deemed to have "control" over C).

CFC taxation is now in addition imposed on foreign (nonresident) taxpayers, which own CFCs through a German PE. For example, if a foreign taxpayer is a controlling partner in a German limited partnership (KG), which owns foreign subsidiaries which are allocable to the German business of the KG, that partner may now be subject to German CFC taxation on the income of the foreign subsidiaries.

All low-taxed income which does not qualify as "active" income (so called "passive" income) is subject to German CFC taxation. The catalogue of active income has, for the most part, in principle been maintained as is. The draft includes ATAD I-mandated changes which broadens the passive income definition for income earned on goods and services purchased from or sold to related enterprises. The most significant changes relate to the treatment of the CFC's dividend income. CFC dividend income is now passive, if: (i) the dividend is a hybrid payment, unless certain narrow exceptions apply; (ii) the dividend is a portfolio dividend (<10% ownership); and (iii) certain other dividends, which would not be exempt under German law, had they been received by a resident taxpayer. On a positive note, the passive income definition for CFC capital gains realized on the disposition of shares has been eased. It is now no longer necessary for the active income qualification of that income category to prove that the sold entity did not own any assets with capital investment character. Likewise, the active income definition of gains realized in corporate reorganizations (e.g., a CFC merger) has been eased. It is now also no longer required to prove the absence of assets with capital investment character for the CFC transferee in qualifying corporate reorganizations, as the investment asset test has been abolished.

The so-called CFC "motive test" or anti-abuse test (according to the *2006 Cadbury Schweppes* decision of the ECJ), which bars CFC taxation of an EU/EEA Member State has been tightened. To meet the test, the language of the law requires now more precisely the presence of a substantial business activity, which the CFC needs to pursue "on its own" on the basis of appropriate operating substance and qualified personnel.

The CFC income is now deemed received by the German tax resident at the end of the fiscal year of the CFC.

Under the current regime, CFC income is deemed received by the German taxpayer a logical second after the fiscal year of the CFC. Because of this timing change, German taxpayers with CFC income from calendar year CFCs will face in 2020 a double attribution of CFC income (2019 and 2020 CFC income is taxed all in 2020).

The CFC law changes would apply effectively to all taxpayers with a fiscal year ending in 2020 (i.e., for taxpayers which are not on a calendar year, the changes apply earlier).

Transfer pricing rules

The Draft Law includes significant changes to the German interpretation of the arm's-length standard as well as to the German TP documentation rules. It aims to update the German TP rules to reflect recent international developments appropriately (mainly the OECD BEPS initiative which resulted among others in the BEPS report for Actions 8-10 "Aligning Transfer Pricing Outcomes with Value Creation" (BEPS Report 8-10), which is included in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 (OECD TP Guidelines). The international developments emphasize the increased economic point of view in transfer pricing with the concept of aligning taxation with value creation. According to the German legislator the contemplated changes in the German TP rules are intended to clarify these aspects and provide for a general set of rules.

The existing section 1 of the *German Foreign Tax Act* (AStG) includes the German interpretation of the arm's-length standard. This section has been completely rewritten, and while some modifications are rather editorial, other modifications constitute significant changes to the current rules. Section 90 of the German Fiscal Code (AO) includes the general German TP documentation obligations, which have been partly updated.

The most notable changes are briefly summarized below:

Definition of an affiliated entity

- The definition of what is considered an affiliated entity is broadened to align the German definition of affiliated entities with the definition in the ATAD Directive.

Changes and clarifications to align with the BEPS Report on Actions 8-10 and OECD TP Guidelines

- The definition of the arm's-length price relies mainly on the accurate delineation of the intercompany transaction and the identification of underlying commercial and legal circumstances and actual behavior of the related parties by performing a detailed function and risk analysis of all parties involved in the transaction.
- It is emphasized that such analysis has to be performed at the time the transaction is agreed upon and the explanatory notes specify that only information that was existent at the time the transfer prices were agreed upon can be utilized.
- The selection of the TP method now follows the OECD TP Guidelines and determines that the most appropriate method for the underlying case should be applied. If comparable third-party data is not available, a hypothetical arm's-length method should be applied utilizing generally accepted valuation techniques.
- In line with the OECD TP Guidelines, adjustment calculations to improve comparability with third-party data shall only be performed if they enhance the reliability of the results.

- The DEMPE concept is newly introduced into German regulations including a definition of what constitutes an intangible. An intangible constitutes an asset that is not a tangible asset or shares, that could be subject to an intercompany transaction without being necessarily separately transferrable and provides a person a factual or legal right regarding the specific asset. Lastly, it is specified that essentially the entity performing the DEMPE functions, assuming risks and providing these assets should be entitled to the intangible-related return. A cash box should be limited to a routine return. Notably this definition focuses on the value contributed by an intangible and not the accounting definition of an intangible asset.
- While most of these aspects have been commonly applied in practice already, the contemplated changes of the Draft Law now incorporate these into German regulations, hence, enhanced legal certainty applies.

Further key changes and clarification

- The determination of the interquartile range is transposed into German law. Whereas in the past the German law required an adjustment to the median if actual transfer prices are set outside said range, the current Draft Law includes a rebuttable assumption allowing the taxpayer to demonstrate that any other value is better reflecting the arm's-length principle.
- The existing escape clauses with respect to the German transfer of function rules that explicitly allow for single asset valuations instead of the transfer package approach under certain circumstances have been deleted in the Draft Law.
- Germany already has a price adjustment clause in its current TP regulations to ensure arm's-length pricing of transactions involving intangibles for which the valuation is considered per se highly uncertain at the time of the transaction. This price adjustment clause is now adjusted to align with the outcome of the BEPS Report for Actions 8-10. Its application is reduced from the current term of 10 years to 7 years to reduce complexity of the application of this rule and enhance tax certainty. Also an explicit definition is now included to define when a significant difference between the financial projections and actual outcomes is actually assumed, namely if the transfer price determined using the actual outcomes deviates by more than 20% compared to the outcome based on the financial projections.

Entry into force

- If the Draft Law passes, companies will need to act swiftly as these rules will apply for financial year 2020, meaning that taxpayers with deviating fiscal years that end after 1 January 2020 will need to consider the TP changes described above for their current fiscal year. Certainly, it is debatable whether such retroactive application will sustain challenges, but this will likely only be decided many years later by the German tax courts.
- The Draft Law mandates the Federal Ministry of Finance (BMF) to provide further guidance on certain aspects by means of a legislative decree. Most notably, such mandate does not include guidance on financial transactions. However, practically speaking there appear to be many aspects of uncertainty particularly in this area.

TP documentation requirements

- TP documentation requirements are further extended. Currently, a German entity of a multinational group only has to prepare a Master File (Stammdokumentation) assuming its revenues amount to at least €100m. This threshold is reduced to €50m.
- Further, a contemporaneous TP documentation requirement is established requiring German entities of multinational groups to submit their Master File electronically to German tax authorities within one fiscal year after the end of the fiscal year the Master File relates to. This is a notable change as Germany currently does not have a statutory deadline for the submission of TP documentation other than upon request, which typically takes place in a tax audit context.
- The contemporaneous documentation requirement for a Master File is applicable for fiscal years beginning after 31 December 2020.
- The current Draft Law does not contemplate any change for the submission of Local Files, i.e., to be submitted only upon request.

Advance pricing agreements

Under existing German law, an APA is the combination of an advance agreement between countries regarding the transfer price between internationally affiliated companies and an advance commitment based thereon. APAs find their legal basis in the respective DTTs, in the respective articles on mutual agreement procedures. The existing APA procedures in Germany are based on a circular issued by the BMF, which contains detailed information and guidance about how APAs are carried out in Germany.

The Draft Law now introduces a legal basis in Germany for the conclusion of APAs with certain changes to the existing APA procedures. The German legislator aims to emphasize its willingness to conduct APA procedures and to demonstrate that legal certainty is of significant importance.

A key change is the possibility for a taxpayer to apply for an APA not only in the context of transfer pricing (i.e., double taxation arising from article 7 or 9 of the OECD Model Tax Treaty), but rather for all cross-border transactions, if the DTT concluded between the countries includes a clause similar to article 25 of the OECD Model Tax Treaty. The Draft Law explicitly offers the possibility for a taxpayer to apply for a multilateral APA to facilitate the administrative burden for an applicant.

An APA process can be initiated upon application, if the APA request is subject to the tax assessment of a clearly defined and - at the time of application - unrealized fact pattern for which double taxation risk exists, which can be prevented by the APA procedure. The APA term shall regularly be not more than five years and can also be rolled-back to previous years upon request considering the legal deadlines in the respective DTT. A signed APA can be renewed upon request as well.

The APA request has to include all information and supporting documents required to assess the specific case from a tax perspective as well as a description and justification of the double tax risk for the case subject to the APA. The APA request may be rejected if the double taxation risk is not sufficiently presented and if it is likely that the APA may not prevent the double taxation for the specific case.

The APA request can be filed either in written form or electronically and must enable the competent authority, which remains the German Federal Central Tax Office (BZSt), to initiate and conduct the APA process.

For transfer pricing cases, the BZSt now charges a fee of €30,000 (increased from €20,000) for processing a new APA request and €15,000 for an APA renewal. The fee for non-transfer pricing cases is reduced to 25% of the fee for TP cases and special fees apply under certain conditions for companies that have been subject to a coordinated bilateral or multilateral joint tax audit as well as for APA requests with smaller transaction volumes.

The new regulation will be applicable for applications filed after the official announcement of the new law. For applications filed before, the current regulations will continue to apply.

Exit taxation for individuals

Broadly, the German exit taxation for individuals is triggered upon the relocation of a German tax resident to a Member State or a third country whereby Germany loses its right to tax the shares. The rules apply in relation to substantial shareholdings (>1%). The revision of the rules was required due to the latest ECJ proceedings.

The new rules proposed by the German Ministry of Finance do not differentiate between transferring the tax residence to a Member State or a third country. While so far, an exit tax deferral was granted for tax residence transfers to Member States until the individual has sold the shareholdings and triggered the capital gain, the deferral shall now be granted by paying the tax in equal installments over a period of seven years ("one-fits-all solution"). I.e., the relocation triggers in all cases directly a capital gain taxation (dry income) without any option for a full and generally unlimited deferral. In this context, it should be noted that changes in the value of the shares after the relocation are not taken into consideration for the purposes of the German exit taxation.

The option for the individual to transfer back its tax residence has generally been maintained and extended by two years to seven years, while the additional option to extend the period by five years remained unchanged. However, even if the motivation to relocate back to Germany is properly substantiated before the relocation, no special deferral will be granted but the payment condition as outlined before (seven installments) will be applied automatically.

The exit tax is only triggered if the individual was a German tax resident for 7 years before the relocation.

Endnote

1. https://www.bundesbank.de/resource/blob/650724/66d28235df1c59bd431d3e8f6b74737c/mL/zsbwp-data.pdf.

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