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Global Tax Alert

Germany publishes draft *Annual Tax Act 2019* and draft bill on Real Estate Transfer Tax Reform

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Executive summary

On 30 July 2019, the German Federal Government (Bundesregierung) published an amended version of the draft *Annual Tax Act 2019* under the name "Tax Act on the continued Tax Promotion of Electromobility and the Amendment of further Tax Regulations." The Government also published a separate draft of the "*Act on the Amendment of the Real Estate Transfer Tax Act*" (Real Estate Transfer Tax Reform).

The initial draft bills were published on 7 May 2019. The legislative process has now been formally started with the publication of the two Acts by the Federal Government. The German Federal Council (Bundesrat) is expected to comment on the draft bills on 20 September 2019 and the legislative process is expected be finalized by the end of 2019. The changes will generally come into effect on 1 January 2020.

This Alert summarizes the following selected items of the two Acts which are relevant for business taxpayers.

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Detailed discussion

Real Estate Transfer Tax Reform (Share Deals)

The long-discussed Real Estate Transfer Tax Reform (RETT Reform) has been formally separated from the *Annual Tax Act 2019* and transferred into a separate legislative process. The proposed amendments of the *RETT Act* mainly include tightened rules on the taxation of share deal transactions involving German real estate. The proposed rules have not significantly changed since the first discussion drafts were published in September 2018.[1] The main changes of the proposed RETT Reform include:

- General decrease of the RETT triggering threshold from 95% to 90% for share deals as well as transactions involving partnerships.
- Extension of the "look-back period" for transfers of interests in partnerships from 5 to 10 years.
- Extension of the so-called "retention periods" for certain exemptions for partnerships from 5 to 10 or 15 years.
- Extension of the so-called "partnership transfer rule" to transfers of shares in a corporation to generally trigger RETT if 90% or more of the shares are transferred to new shareholders within 10 years.

The draft bill also includes further anti-avoidance measures such as the prevention of real estate sales under market value within the period of retroactivity of certain reorganizations or the abolition of an upper limit for late payment fees for RETT purposes.

Whereas the new rules under the draft bill will generally be applicable after 31 December 2019, the draft bill includes comprehensive and complex transitory rules. It should be noted that during the legislative process the effective date may still be accelerated to 2019.

Trade Tax: Exemption privilege for non-domestic dividends

The draft bill of the *Annual Tax Act* includes an amendment of Sec. 9 No. 7 *German Trade Tax Act* (GewStG) in reaction to a ruling of the European Court of Justice (ECJ) dated 20 September 2018 (case "*EV*", C-685/16). The ECJ ruled on that case that the higher prerequisites that exist for third-country dividends compared to domestic dividends (e.g., activity clause and conditions for sub-subsidiaries) violate European Union (EU) law. German tax authorities already issued, on 25 January 2019, a coordinated state decree which suspended these higher prerequisites for third-country dividends in all open cases.

The draft bill now comprises the abolishment of higher prerequisites for third-country dividends within the GewStG. According to the proposed amendments, there would be no differentiation anymore, whether a dividend is distributed by an EU tax resident company or a non-EU tax resident company. The trade tax exemption privilege would uniformly apply in the future, if the participation at the beginning of the tax period is at least 15%. The abolishment of a special rule for EU-country dividends means at the same time an increase of the minimum participation from previously 10% to 15%.

The trade tax exemption privilege for domestic dividends remains unchanged and still requires a minimum participation of 15%. The exemption privilege for Corporate Income Tax purposes also remains unchanged and still requires a minimum participation of 10%.

Subsequent acquisition costs for shares in corporations

The draft bill of the *Annual Tax Act* includes a new provision in Sec. 17 (2a) *Income Tax Act* (EStG), which defines acquisition costs of shares in corporations held by individuals in accordance with Sec. 255 HGB (German local GAAP). According to the rule, acquisition costs include all expenses that were incurred to acquire the shares. In addition to the purchase price, this includes ancillary costs (e.g., notary fees) and subsequent acquisition costs. The expenses which are part of the subsequent acquisition costs are defined by way of examples and a non-exhaustive list.

The new rule regulates, inter alia, that as far as a loan was granted or the repayment was put on hold due to a crisis of the borrowing corporation only because of a corporate relationship, a capital loss shall be treated as subsequent acquisition costs for the shares in the borrowing company. The new rules were introduced due to past disagreements between tax authorities on the one hand and tax jurisprudence on the other hand. Tax authorities supported such treatment as subsequent acquisition costs e.g., in their decree dated 21 October 2010, which was later partially abolished in a decree dated 5 April 2019 in reaction to a contrary position taken by the German Federal Fiscal Court (BFH). The BFH had ruled that such a treatment as subsequent acquisition costs should not apply for so called

equity-replacing loans (eigenkapitalersetzende Darlehen), if these loans were granted under new commercial law rules which were introduced by the so-called "MoMiG" legislation with effect as of 1 November 2008.

According to the explanatory notes to the draft bill, this amendment should also compensate for consequences of the proposed tightening of the rules for the deductibility capital losses, which is also included in the *Annual Tax Act 2019*. According to this new rule, losses resulting from e.g., unrecoverable capital claims can no longer be considered as capital losses to off-set capital gains.

Income Tax: Incentives for electromobility

The draft bill of the *Annual Tax Act 2019* includes several amendments to the *Income Tax Act*, including wage tax incentives, to further attract investments into environmentally friendly electromobility, e.g.,:

- Extension of company car incentives for electronic and hybrid vehicles (timely extension of the rules which were implemented in the *Annual Tax Act 2018*)[2]
- A special depreciation rule for purely electric delivery vehicles: special deprecation of 50% of the acquisition costs of a qualified electric vehicle in the year of acquisition
- Lowering of trade tax add-backs for rent and lease payments for electric vehicles, bikes (not motorized) and externally chargeable hybrid vehicles to 10% (decrease of add-back percentage from 25% for "regular" rent and lease payments for movable property)

Value-Added Tax Act: Quick fixes and other amendments

The draft bill contains various amendments to the *VAT Act* (UStG) which include both anti-avoidance measures as well as mandatory adjustments due to EU legislation and ECJ case law. The focus of the changes are new provisions (so-called "Quick Fixes") affecting intra-community supplies between entrepreneurs of different EU member states.

- Increased verification requirements for intra-community supplies: additional condition for VAT-exempt intra-community supplies shall be the timely, complete and correct submission of a recapitulative statement (zusammenfassende Meldung).
- New provision for call-off stock arrangements: Until now there has been no provision for call-off stock arrangements in the *German VAT Act* which often has the effect that no intra-community supply is possible in connection with call-off stock arrangements: mostly such call-off stock arrangements were broken up into: (i) an intra-community transport/acquisition and (ii) a local supply in the member state of destination. According to the proposed rules, a VAT-exempt intra-community supply would now still be possible, despite a call-off stock arrangement interrupting the transport. Inter alia this requires a maximum of 12 months between the end of the transport into the call-off stock and the later supply to the customer.
- New regulation for the place of supply in intra-community chain transactions: Adoption of new EU legislation which was introduced to reach an EU-wide harmonization. The new legislation closely resembles the current German regulations, which means that the main principles and definitions of an intra-community chain transaction remain unchanged. The transport (movement of goods) can still only be ascribed to one of the supplies (only this intra-community supply/export may be VAT-exempt). Some of the existing administrative instructions on how to determine the "moved supply" will be incorporated into the *VAT Act*.

The draft bill includes further amendments such as the denial of an input VAT deduction and tax exemptions in cases where a tax evasion occurs in a previous or subsequent transaction under the condition that the taxpayer knew or should have known about the tax evasion. This rule is a consequence of ECJ case law and aimed at fighting so-called missing trader or carousel fraud.

Endnotes

1. See EY Global Tax Alert, *German Real Estate Transfer Tax reform plans for "share deals" unveiled*, dated 26 September 2018.
2. See EY Global Tax Alert, *German Federal Parliament adopts Annual Tax Act 2018*, dated 15 November 2018.

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