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Practice Group:

Tax

Readjustment of taxation of free floating dividends and of fiscal unity – Current legislative procedures

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Reform of taxation of free floating dividends for corporate income tax purposes

The German Parliament *(Bundestag)* and the German Federal Council *(Bundesrat)* reached an agreement regarding the taxation of free floating dividends received from holdings of less than 10 % *(Streubesitzdividenden)*. In future and with respect to companies, these dividends shall be subject to general taxation.

With its bill to implement the ECJ judgement of 20 October 2011 in Case C-284/09, the German Parliament originally intended to extend the already existing tax exemption for companies which are subject to unlimited tax liability to EU/EEA companies which are only subject to limited tax liability or rather enabling a repayment of taxes withheld. The German Federal Council initially disagreed with this project but agreed to the following compromise:

- Free floating dividends paid to companies which are subject to unlimited tax liability and companies which are subject to limited tax liability shall, in future, be subject to corporate income tax in both cases. The previous tax exemption according to Section 8b Paragraph 1 CITA (Corporate Income Tax Act) is not applicable – according to Section 8b Paragraph 4 CITA (new) – if the respective participation in the capital of the company amounts to less than 10 % at the beginning of the calendar year.
- The current tax exemption of capital gains derived from the alienation of shares or stocks in a company according to Section 8b Paragraph 2 CITA remains unchanged. With respect to this exemption, the participation in the capital of the company is irrelevant.
- The German Reorganisation Tax Act and the Investment Tax Act will be modified to reflect the new law in order to ensure a synchronism between the respective tax acts.
- The new law is applicable to dividend distributions received after 28 February 2013.

Reform of corporate income tax fiscal unity

The German Parliament and the German Federal Council have also reached an agreement regarding the bill amending the law on taxation of companies and the law on travel expenses. One key aspect of the bill – besides its extensive reform of the law on travel expenses for income tax purposes – is the reform of the corporate income tax fiscal unity *(Organschaft)*.

The objective of the reform is both the simplification of the rules regarding the fiscal unity as well as the adaption of recent decisions of the European Court of Justice and the German Federal Fiscal Court.

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The key aspects of the reform may be summarised as follows:

- The controlling entity *(Organträger)* no longer has to be subject to German unlimited tax liability. Rather, the controlling entity's participation in the controlled entity (*Organgesellschaft)* has to be continuously allocated to a German permanent establishment of the controlling entity and Germany has to have the right to tax any income derived from the participation according to German tax law as well as to the applicable double tax treaty. This also applies if the controlling entity's participation in the controlled entity is indirectly held via a partnership.
- The so-called "double domestic nexus" *(doppelter Inlandsbezug)* of the controlled entity as a prerequisite for the recognition of a fiscal unity will be abandoned. In the past, the controlled entity must have had its corporate seat and central place of management in Germany. In future, the controlled entity may have its corporate seat in another EU or EEA member state.
- The new law now provides remedies with respect to certain incorrect balance sheet amounts which means that cases covered by the new law will not necessarily lead to the conclusion that the profit-and-loss transfer agreement was not properly executed.
- With respect to the controlling entity's obligation to cover the controlled entity's losses, the profit-and-loss transfer agreement between a limited liability company *(GmbH)* and its controlling entity must, in future, contain a dynamic reference to Section 302 of the German Stock Corporation Act *(Aktiengesetz)* in its currently valid version. The bill provides a deadline of 31 December 2014 for "old" agreements: until this date the missing dynamic reference will not be challenged by the tax authorities.
- The fiscal unity may not claim tax losses in Germany if the respective tax losses of the fiscal unity have already been taken into account for taxation abroad. The purpose is to avoid the double use of cross-border losses.
- The profits (or losses) of the controlled entity which are attributable to the controlling entity have to be filed in a uniform determination of profits in the future.

After the new law was announced in the Federal Law Gazette on 25 February 2013, it was principally applicable to all tax assessments which were not already final and binding. Therefore, we recommend checking already existing profit-and-loss transfer agreements and structures on their compliance with the new law.

Forecast

Finally, we would like to report on further tax legislative procedures which are currently pending before the German Parliament and the German Federal Council.

After the Annual Tax Act 2013 *(Jahressteuergesetz 2013)* in its version of 2012 failed to be enacted, parts of the previous Annual Tax Act 2013 – in particular, rules to approximate the German VAT Act *(Umsatzsteuergesetz)* to the law of the EU and to the decisions of the European Court of Justice and rules that prevent the use of losses in connection with foreign gold investment models – were reintroduced to the German Parliament as part of the Mutual Assistance Directive Implementation Act *(Amtshilferichtlinie-Umsetzungsgesetz)*. In addition, the German Federal Council in its meeting on 1 March 2013 decided to introduce its own Annual Tax Act 2013 – including rules regarding the so-called "Cash-GmbH" for inheritance tax purposes, rules regarding the so-called "RETT-blocker-structures" for real estate trading tax purposes and rules regarding hybrid financing models – to the German Parliament. The outcome of these bills is open.

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The reform of the tax law of charitable organisations has passed the parliament, but in the foreseeable future the German Parliament and the German Federal Council still have to approve the Simplifying Tax Act 2013 *(Steuervereinfachungsgesetz 2013)* which was initiated by the German Federal Council and which contains rules to adjust Sec. 15a of the Income Tax Act *(Einkommensteuergesetz)* to the so-called "tax balance sheet model". Furthermore, the German Parliament and the German Federal Council will have to decide upon the reform of the investment tax law as a consequence of the creation of the new German Capital Investment Act *(Kapitalanlagegesetzbuch)*.

With these bills pending, tax legislation remains exciting. We will keep you informed.

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