

ANTI-TAX AVOIDANCE DIRECTIVE IMPLEMENTATION ACT

Draft bill dating March 2020



At the end of March of this year, the Federal Ministry of Finance re-published its draft bill regarding the Act on the implementation of the Anti-Tax Avoidance Directive (ATAD Implementation Act bill) and thereby resumed its work on the legislative procedure, which was last interrupted in December of 2019. In addition to the new regulations concerning Transfer Pricing, regarding which we will inform you separately, the ATAD Implementation Act bill also contains new rules concerning the exit taxation of business assets and the personnel exit taxation as well as hybrid mismatch rules and the controlled foreign corporation (CFC-)regime. It partly serves the purpose of preventing from so called "white income" or double tax advantages. This however, partially results in substantial disadvantages on owner and company level.

EXIT TAXATION FOR BUSINESS ASSETS

The exit taxation for business assets has been defined as a withdrawal in para. 4 sec. 2 sent. 3 German Income Tax Act and results in a taxation of hidden reserves, just as in the case of a selling. The counterpart of withdrawal has been defined as a contribution in para. 4 sec. 1 sent. 8 2nd half sentence German Income Tax Act. This regulation however, contained a loophole, as the tax contribution applied in the moment of the restriction of the German taxation right, but it only occurred when the German taxation right was established. This loophole was intended to be closed in a way, that the mere strengthening of the German taxation right already represents a contribution.

In case of a contribution of assets into the German taxation regime, the valuation of assets will now be linked to the valuation of the assets in the country of the withdrawal. Subsequently, a higher valuation of assets can only occur, if the contribution in Germany was preceded by a withdrawal abroad and thus a re-recognition of "old" hidden reserves in Germany can be prevented from. The maximum value in this regard is supposed to be the fair market value.

An alignment of the respective regulations is intended regarding para. 12 German Corporation Income Tax Act analogously.

PERSONNEL EXIT TAXATION

The exit taxation for shareholders according to para. 6 German Foreign Tax Act will be reformed in its entirety. This will have massive negative effects on mobility and internationalization of owner families. The new regulation is already applicable, if the exiting person has had an unlimited tax liability for the previous seven years instead of ten years like before. The observation period is now limited to twelve years.

Grossly unfair and with a negative impact on liquidity is furthermore, that the rules of deferred payment are being unified. The differentiation between an exit to an EU/EEA country on the one hand and to a third country on the other, was eliminated. For all cases, the only option is a seven-year (two-year extension) deferral in instalments, which is now ought to be interest-free. However, in principle, a security deposit has to be paid. The previously unlimited deferral of payment in the event of an exit to an EU/EEA country was eliminated. Due to the severe negative impact on liquidity, this represents an attack on the mobility of owner families.

At least the possibility of returning after the exit will be extended by two years to twelve years under the exit taxation regime.

ABOUT BDO

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HYBRID MISMATCH RULES

Para. 4k German Income Tax Act contains a completely new regulation prohibiting the deduction of business expenses in case of certain hybrid mismatches. With para. 4k German Income Tax Act, business expenses are not deductible for tax purposes, if the corresponding revenue on behalf of the payee is not taxable or if the business expense is also deductible in another state. The basis for this non-taxation of revenue or double deductibility of business expenses is ought to be a mismatch in qualification or attribution of payments. It is important to note in this context, that the outlined provisions only apply to arrangements between related parties. However, arrangements, in which several parties establish a concerted practice or share a tax advantage economically, qualify as between related parties.

The protection under double taxation treaties should explicitly not apply to the limitation of the deduction of business expenses (Treaty Override).

CONTROLLED FOREIGN CORPORATION REGIME

The German CFC regime based on paragraphs 7 and following of the German Foreign Tax Act (GFTA) will be newly regulated. This also has an impact on international groups and companies, especially those with foreign (intermediate) holding structures. The basic structure of the regulations remains unchanged, but some of the rules will tighten up.

The previous core element of „domestic control“ will be replaced by individual control of the person with unlimited tax liability. On the one hand, this eliminates the typical coincidental cases, in which a person with unlimited tax liability is only subject to the CFC regime, because other persons with unlimited tax liability hold an independent and non-cooperative interest in the target company. On the other hand, shares and interest of „related parties“ are now also attributed to the individual with unlimited tax liability, regardless of their residency. In this context, the model of concerted practice between unrelated parties will also be included into German taxation law, in order to capture cooperation between family members. Due to a new legal assumption the direct or indirect partner of a partnership are deemed to work in concerted practice together so that the shares in the CFC held by a partnership are allocated to the German resident partner. Therefore, FO-structures and family owned entities are to be urgently assessed regarding this new provision.

In summary, groups, which were previously out of focus due to the lack of domestic control of the target company, will now be subject to the CFC regime.

Unfortunately, the widely criticized threshold for the qualification of “low taxation” remains unchanged. It remains at an internationally unacceptably high level of 25 %. Consequently, most countries are low tax countries according to this CFC rule.

As before, the legislator intends to maintain the provision, that all income is „passive“, if it is not explicitly stated to be „active“. The catalogue of active income is structured as before but contains selective constrictions. This applies to dividend income, which now becomes „passive“ under certain conditions. This results in implications on traditional holding entities abroad.

In addition, the participation rules for service and trading companies, which also have been criticized for some time now, have unfortunately not been sufficiently „modernized“.

Passive low taxed income will now be directly attributed to the first domestic taxpayer according to his participation quota. The allocation through the participation chain on every level was eliminated.

Income of capital investment nature continues to trigger the applicability of CFC rules at a participation rate of 1 % – in individual cases even lower. This provision now moves from para. 7 sec. 6, 6a to para. 13 GFTA.

Lastly, it is unfortunate that the substance test in para. 8 sec. 2 GFTA essentially remains limited to the EU/EEA area as an escape from the CFC regime.

COMING INTO FORCE

The bill currently intends for the ATAD regulations to come into effect as of January 1st of 2021. However, a political consensus regarding the bill has not been achieved yet and it thus remains to be decided, to what extent the draft bill will be amended in course of the legislative procedure.

ACTION REQUIRED

At this stage already, companies acting across borders as well as their owner families and investors should assess the potential impact of the bill. The further development of the implementation of the Act should be observed.

EFFECTIVE SUPPORT FROM BDO

You are welcome to get in touch with your local BDO contact person regarding a quick check in order to identify a possible need for action or the use of grandfathering rules. We will be happy to support you in making any necessary adjustments or recommendations for action. If required, we will collaborate with our colleagues from the respective BDO Member Firms of our international network in more than 160 countries.