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Recent Developments in International Taxation

Germany

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Introduction

In Germany, numerous legislative changes have been initiated in the past 12 months, which will play a significant role, especially in cross-border activities.

Growth Opportunities Act of 27 April 2024

The Growth Opportunities Act, aimed at strengthening growth opportunities, investments and innovation, as well as tax simplification and fairness, was primarily intended to provide noticeable relief to companies in Germany to generate corresponding growth. The goal was to encourage companies to invest more permanently and take entrepreneurial risks with innovation. However, after prolonged political wrangling over individual regulations, only a fraction of the originally planned relief measures remained. Among the still numerous, partly very detailed measures, the following are particularly noteworthy with regard to cross-border activities.

Loss consideration in tax groups

The regulations on loss consideration in tax groups (in combination with dual-resident companies) were amended. Prior to the amendment, the losses of companies in a tax group were not considered in the German tax base if the losses were considered in a foreign state for taxation purposes. The regulation aimed to prevent dual-resident companies from utilising losses both domestically and abroad or, according to national regulations of foreign states, always to the detriment of the Federal Republic of Germany.

Cross-border financing relationships and services

New regulations for cross-border financing relationships and services were introduced. The changes aim to further curb profit-shifting strategies and clarify the arm's length principle. This is to ensure that profits are taxed where they economically arise. In particular, it aims to prevent international corporate groups from generating deductible expenses in the form of interest through cross-border financing with the goal of reducing their tax base. Besides strict requirements on the allowable amount of loan interest, which must withstand the arm's length test, it must also be credibly demonstrated that the debtor could service the debt from the beginning of the financing relationship throughout its duration, and that financing is economically necessary and used for business purposes. The term 'financing relationship' is broadly defined, covering not only loan relationships but also the use and provision of debt or debt-like instruments.

Function and risk profile in financing relationships

Additionally, the function and risk profile in financing relationships are legally regulated. According to this, financing services are generally considered low-function and low-risk services if a financing relationship is mediated by one company to another within a multinational corporate group or if a financing relationship is forwarded from one company to another within a multinational corporate group. These principles also apply if a company

in a group manages financial resources for other companies in the group, such as liquidity management, financial risk management, currency risk management or acting as a financing company. As a result, financing companies are generally classified as low- function and low-risk entities within corporate groups. However, this general classification does not apply if it can be proven through function and risk analysis that no low-function and low-risk service exists.

The adjustments to cross-border financing relationships primarily lead to stricter documentation requirements for taxpayers. The regulation appears to demand long-term corporate planning, documented usage intentions and particularly regular costly benchmark analyses. If these become the prerequisites for recognising intra-group financing relationships in Germany, the attractiveness of financing for German group companies will be significantly reduced. The adjustments go beyond Organisation for Economic Co-operation and Development standards and are not internationally coordinated.

International risk assessment procedure

An international risk assessment procedure was introduced. This involves a joint assessment of tax risks from already realised facts with one or more states or territories in a procedure based on cooperation and transparency. The tax risks are assessed considering the scope and plausibility of the documents and information provided by the taxpayer, the expected tax impacts, and the anticipated time and personnel expenditure for an in-depth examination of the facts. If the risk of tax loss is assessed as low while maintaining the declared or adjusted information within the international risk assessment procedure concerning the evaluated facts, the determination of the taxpayer's tax situation in an external audit may be waived. The international risk assessment procedure can be initiated by the leading company in the group.

Credit Secondary Market Promotion Act of 29 December 2023

Interest barrier rule

The interest barrier rule was adjusted less restrictively than previously planned. In particular, the highly controversial anti-fragmentation rule was not implemented. In addition, the new rule on a supplementary interest cap was not pursued further.

Minimum Tax Act of 21 December 2023

Minimum tax rate of 15 per cent

The Minimum Tax Act introduced a global minimum tax rate of 15 per cent for business units located in Germany for large corporate groups exceeding a turnover threshold of €750m in the consolidated financial statements of the ultimate parent company in at least two of the last four preceding fiscal years. The tax liability of business units located in Germany is independent of the respective legal form. Corporate groups with minor international activities, as well as purely national corporate groups, are exempt from the tax for the first five years. The minimum taxation is ensured by introducing a primary top-up tax rule, a

secondary top-up tax rule and a national top-up tax rule. The secondary top- up tax rule is generally applicable to fiscal years beginning after 30 December 2024.

Controlled foreign company and royalty barrier rule

Furthermore, the controlled foreign company (CFC) rules, which lead to an add-back taxation parallel to the minimum tax, were adjusted. The effective tax rate below which the rule applies was reduced to 15 per cent. The same applies to the royalty barrier rule.

Anti-Tax Haven Act of 25 June 2021

From 1 January 2024, the Anti-Tax Haven Act, which aims to encourage non-cooperative tax jurisdictions to implement international taxation standards, will be newly applicable to Russia, Antigua and Barbuda, Belize and the Seychelles (in addition to American Samoa, Anguilla, the Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, the Turks and Caicos Islands, the United States Virgin Islands and Vanuatu). Consequently, the following measures, among others, apply to taxpayers with business relationships with these tax jurisdictions:

- stricter add-back taxation, even for active business activities, from 1 January 2024;
- expanded catalogue of limited taxable income (eg, for income from financing relationships, insurance and reinsurance services, the provision of other services or trading in goods);
- measures for profit distributions and share sales from 1 January 2026;
- prohibition of the deduction of operating expenses and advertising costs from 1 January 2027; and
- increased cooperation and documentation obligations regarding business relationships, contractual terms or assets.