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Recent developments in international taxation: Germany

Over the past 12 months, various legislative amendments have resulted in changes to German tax law. The following are of particular interest.

Annual Tax Act 2024 of 2 December 2024
The Annual Tax Act 2024 is a technical tax amendment act dealing with a great variety of tax law aspects and does not have an overarching objective. Of the many amendments, the following ones are the most important for taxpayers resident abroad.

Employment income paid for periods of gardening leave related to the termination of an employment contract
Effective since 1 January 2024, employment income paid for periods of gardening leave related to the termination of an employment contract has been subject to tax in Germany for non-tax residents if the hypothetical work had been carried out in Germany (Section 49 (1) no 4 (f) of the Income Tax Act (*Einkommensteuergesetz*)). This amendment supplements the existing regulation under which severance payments for the termination of employment contracts are subject to tax in Germany as far as the income from the employment has been subject to tax in Germany. Consequently, if a taxpayer leaves Germany, is on gardening leave up to the termination of their contract and receiving income for that period of gardening leave, since 1 January 2024 the income has been subject to tax in Germany if the hypothetical work would have been carried out in Germany.

The legislature also introduced a new paragraph for the interpretation of double taxation agreements (DTAs) involving Germany, complementing this new domestic regulation (Section 50d (15) of the Income Tax Act). Under that new DTA interpretation, income paid for periods of gardening leave related to the termination of an employment contract is deemed to be income paid for work performed in the country in which the work would have been carried out if the employee had not been placed on gardening leave. For this to work, the DTA must not contain a specific regulation for such income. Consequently, from a German perspective, DTAs principally do not restrict the German taxation right for income paid for periods of gardening leave related to the termination of an employment contract if the employee is physically outside of Germany during that period. This interpretation of DTAs is in accordance with the OECD-commentary (Article 15, margin 2.6).

Trade tax liabilities for income from foreign permanent establishments
In principle, only income attributable to domestic permanent establishments (PEs) is subject to German trade tax (*Gewerbesteuer*). There is an exception for income of foreign PEs that would be subject to German controlled foreign companies (CFC) taxation if the PEs were companies (Section 7, sentence 8 of the Trade Tax Act (*Gewerbesteuergesetz*)). The wording of the previous version of that exception indicated that it may apply only if the foreign PE income was exempt under a DTA and not if foreign taxes were credited against German tax liabilities under a DTA. Under the newly amended regulation, trade tax applies to foreign PE

income that would hypothetically be subject to CFC taxation, irrespective of whether the foreign income is exempt, foreign taxes are credited against German taxes under a DTA or if there is no DTA at all.

Exit taxation for privately owned shares in investment funds
Until FY 2024, German tax law stipulated exit taxation for business assets and privately owned shares in companies of at least 1 per cent of the company's share capital only. For that reason, some taxpayers apparently transferred their shares into investment funds prior to expected increases of value of those shares. Later, they could leave Germany without being subject to exit taxation regarding value increases of the investment fund shares.

Under newly implemented amendments (Sections 19 (3) and 49 (5) of the Investment Tax Act (*Investmentsteuergesetz*)), the German legislature has introduced exit taxation for German residents in relation to privately owned investment fund shares, provided that, in the five years prior to the exit, the investor either directly or indirectly owned at least 1 per cent of the shares of the fund or has invested at least €500,000 as acquisition costs in the fund. This new exit taxation applies to exits occurring after 31 December 2024. The scope covers both shares in general investment funds and special investment funds as defined under the German Investment Fund Tax Act. The exit taxation does not apply in case of losses.

An exit event is defined as either (1) the taxpayer abandoning their tax residency in Germany, (2) a transfer without consideration of the fund shares to a person who is not tax resident in Germany, or (3) a loss or a restriction of the German taxation right regarding profits from selling the fund shares. German tax residency is defined as having been tax resident in Germany for at least seven years out of the preceding 12 years.

However, according to its wording, the exit taxation does not apply to fund investments spread over different funds provided there is no single investment in one fund that exceeds the threshold of 1 per cent of the fund volume or an investment of at least €500,000. As with the German exit taxation for privately owned shares in companies, there is an escape clause if the former taxpayer relocates back to Germany within seven years after leaving. In such cases, the exit tax liability is revoked to the extent that (1) the taxpayer has not sold the fund shares or reassigned them as business assets, (2) there have not been any profit distributions to the (former) taxpayer, and (3) the German taxation right regarding the fund shares is re-established at least to the extent that it used to have before the exit.

Prevention of double real estate transfer tax for one transfer of shares in certain real estate companies
The legislature also introduced a regulation to prevent double taxation in certain real estate transactions (Section 1 (4a) of the Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz*)). The German tax authorities took the view that real estate transfer tax must be paid twice on the sale of a company if that company had previously acquired the shares in a real estate-owning company. The reason was that the real estate was apparently attributable to both the parent company and the subsidiary, and therefore two taxable events shall have occurred even though only the shares of one company have been transferred.

With its recent amendment, the legislature remedies that situation and stipulated that the real estate is only attributed to one company. Consequently, the issue of double taxation is resolved for such cases. However, this rectification only applies for transfers taking place after 5 December 2024. For all realised transactions up to 5 December 2024, the threat of double taxation remains.

Tax-neutral transfer of an asset among partnerships with identical partners
German tax law provides for tax-neutral transfers of business assets among various businesses of one taxpayer and from the business of one taxpayer into a partnership that they are a partner of (Section 6 (5), sentences 1–3 of the Income Tax Act). The relevant section did not apply to transfers of one asset from one partnership to another even if all partners of both partnerships are identical. The Federal Constitutional Court (Bundesverfassungsgericht) ruled that as unconstitutional in 2023. The legislature has therefore amended that section. The new amendment provides for a tax-neutral transfer of an asset among partnerships with identical partners.

Bureaucracy Relief Act IV of 23 October 2024

Amended requirements for the documentation standard of transfer pricing
The documentation requirements for transfer pricing have been revised. Under the new regulations, a matrix report containing relevant information regarding transactions with related parties in cross-border cases must be provided to the German tax authorities within 30 days once they file a request for the report. In particular, the matrix report is required to contain information regarding:

- the kind of the respective transaction;
- provider and recipient;
- provided consideration;
- the contractual basis; and
- the applied transfer pricing method.

The new transaction report should assist in identifying key issues in a tax audit. In the case of a tax audit, the taxpayer is required to transmit documentation within 30 days without a specific request (Section 90 (4), sentence 3 of the General Tax Code (*Abgabenordnung*)).

In contrast to the previous legal framework, not all transfer pricing documentation must be provided to the tax authorities in a tax audit unless specifically requested. Only the matrix report, the master file and documentation regarding extraordinary transactions must be provided. According to the legislature, this is intended to facilitate faster and more efficient tax audits.