tax notes international

Volume 62, Number 12 ■ June 20, 2011

Tax Proposals Advance

by Sabine Demel

Reprinted from *Tax Notes Int'l*, June 20, 2011, p. 944

COUNTRY DIGEST

Tax Proposals Advance

German tax law will undergo several major changes in 2011. This article outlines the legislative initiatives and details the most important changes.

EU Assistance Directive

On May 4 the German Federal Cabinet approved a draft bill on the implementation of the EU mutual assistance directive and other changes in tax law (Gesetz zur Umsetzung der Beitreibungsrichtlinie sowie zur Änderung steuerlicher Vorschriften). The draft bill is based on the initial draft version the Ministry of Finance issued March 31.

Overview

The bill's objective is to incorporate into domestic law by December 30, 2011, the EU directive of March 16, 2010, on the mutual assistance for the recovery of claims relating to taxes, duties, and other measures.[1] However, it also proposes several other important changes to German tax law.

The bill would do the following:

- amend the regulations for electronic wage tax deductions and cancellation of the transitional rules;
- introduce a tax exemption for pensions received by persons who qualify as persecuted under the German compensation law (Bundesentschädigungsgesetz);
- introduce an annual minimum contribution of €60 for indirect beneficiaries under the retirement plans of section 10a and sections 79-99 of the Income Tax Act;
- expand the catalogue of voluntary services in the context of tax-based family support, introducing the international youth voluntary service;
- more closely connect the basic tax-free amount and deductions of special expenses for nonresident employment income;
- introduce an automatic withholding tax procedure for the church tax regarding German capital income that is subject to taxation at source (*Abgeltungsteuer*);
- abolish the reorganization clause of the German change of control rule following the European Commission ruling (section 8c, paragraph 1a Corporation Tax Act (CTA));
- update the base values for determining fair value according to the asset value method (*Sachwertverfahren*) under the Valuation Act (Bewertungsgesetz);
- allow nonresident taxpayers to opt for resident taxation under the Inheritance and Gift Tax Act;
- align the tax fraud regulations with the European consumption tax system; and
- prevent abuse of the employee savings allowance for some real estate distribution models.

Most Important Changes

Reorganization Clause

The so-called reorganization clause of section 8c, paragraph 1a CTA was introduced in July 2009 with retroactive effect from January 1, 2008. It contained an exemption from the change of control rule of section 8c, paragraph 1 CTA for a share transfer involving the financial reorganization of a corporation. On January 26, 2011, the European Commission ruled that the reorganization clause violated European state aid rules because it distorted competition within the European single market. (For the commission release, see *Doc 2011-1999* or *2011 WTD 20-27*; for prior coverage, see *Tax Notes Int'l*, Feb. 7, 2011, p. 424, *Doc 2011-2077*, or *2011 WTD 21-1*.)

Germany must reclaim any tax benefits granted under the rule since January 1, 2008. Those benefits total approximately €1.8 million for the years 2007-2009, according to information the German Ministry of Finance provided on May 3, 2011.

Because of the commission's inquiry, the reorganization clause has not been applied since April 30, 2010, even in cases when an advance ruling had been granted. The draft bill seeks to abolish the reorganization clause effective January 1, 2011.

[1] EU Directive 2010/24/EC, Official Journal of the EU No. L 84, Mar. 31, 2010, p. 1.

For tax years 2008-2010, the government announced March 9 that it would appeal the commission's decision before the European Court of Justice. (For the German MOF release, see *Doc 2011-5449* or *2011 WTD 51-16*.) If the ECJ rules in favor of Germany, the reorganization clause would apply for tax years 2008-2010, so any share transfers under the reorganization clause should not be included when determining harmful share transfers under the German change of control rule. It is advisable to keep the assessment notices open.

Automatic Withholding Tax Procedure for Church Tax

An automatic withholding tax procedure would be introduced for the church tax on capital income subject to withholding tax. Financial institutions — comprising not only banks but also insurance companies and home loan banks (*Bausparkasse*) — would now be required to withhold church tax on capital income. The purpose of the amendment is to protect church tax revenue.

For financial institutions to withhold church tax, they would first have to initiate an inquiry with the Federal Tax Office (Bundeszentralamt für Steuern) to determine if the taxpayer is subject to church tax. If it is, the Federal Tax Office would not inform the financial institution of the taxpayer's religious denomination but only of the applicable church tax rate. Thus, data protection would be ensured.

If the taxpayer is subject to church tax, the financial institution would determine the church tax amount to be withheld and pay it to the local tax office together with the withholding tax on capital income. The financial institution must also inform the Federal Tax Office of the amount withheld for the taxpayer. The Federal Tax Office would then inform the local tax office which religious denomination the withheld church tax must be allocated to.

The new rule would take effect for capital income that is received after September 30, 2013.

Residence and Inheritance and Gift Tax

German inheritance and gift tax law provides nonresident taxpayers with a tax-free allowance of €2,000 irrespective of the relationship between testator and successor. For resident taxpayers, the allowance ranges from €20,000 to €500,000 depending on the relationship. In its April 22, 2010, decision, the ECJ held that that difference restricted the free of movement of capital. The commission on March 14 asked Germany to remove the restriction. The bill would do so. (For the ECJ decision in *Mattner* (C-510/08), see *Doc 2010-8943* or *2010 WTD 78-15*; for the commission release, see *Doc 2011-5339* or *2011 WTD 50-14*.)

Nonresident taxpayers that are tax resident in and citizens of an EU/European Economic Area country could apply to be taxed as residents. Thus, nonresidents would have access to a higher tax-free amount. However, their total worldwide assets would be subject to German inheritance and gift tax. (Nonresident taxation usually comprises only assets with a qualified relationship to Germany — for example, immovable property located in Germany.)

Like for every person subject to resident taxation, the tax rate would be determined based on the total assets even if portions of the assets are not subject to German inheritance and gift tax because of a tax treaty (*Progressionsvorbehalt*), and foreign inheritance and gift tax would be credited against the German tax. (Six German tax treaties are in force concerning inheritance and gift taxation.)

Thus, applying for resident taxation will be beneficial if the higher tax-free amount compensates for the taxation of worldwide assets.

To prevent abuse from repeated gifts between the same persons, transfers within a period of 10 years will be totaled and an overall tax amount will be calculated.

Resident taxation could be applied for if the tax arises the day after the law's enactment (the tax arises for German inheritance and gift tax purposes with the death of the testator and the granting of the gift). Resident taxation could apply for all open tax assessments if the taxpayer files a declaration.

Electronic Wage Tax Deduction

The wage tax deduction based on electronic wage tax attributes was introduced by the 2008 annual tax bill. Previously, every taxpayer receiving employment income received a paper wage tax card containing the relevant information. That wage tax card was distributed for the 2010 tax year and continues to apply for the 2011 tax year. Starting January 1, 2012, the new electronic procedure will apply.

Schedule for Draft Bill on Implementation of EU Mutual Assistance Directive and Other Tax Law Changes

June 17, 2011	First consultation in the Bundesrat
June 30, 2011	First lecture in the Bundestag
July 6, 2011	First consultation in the Finance Committee of the Bundestag
September 26, 2011	Hearing of Finance Committee
October 19, 2011	Final consultation of the Finance Committee
October 20, 2011	Second and third lecture in the Bundestag
November 25, 2011	Second consultation in the Bundesrat

Simplification of German Tax Law 2011

The Bundestag's Finance Committee on June 9 published its report on the 2011 bill regarding the simplification of German tax law 2011 (Steuervereinfachungsgesetz 2011). (For prior coverage of the tax simplification act, see *Tax Notes Int'l*, Apr. 4, 2011, p. 33, *Doc 2011-6714*, or *2011 WTD 62-4*.)

Overview

The bill would reduce taxpayers' (individual persons as well as companies) tax declaration duties and seeks to reduce the tax burden of families and recipients of employment income. The proposed amendments would reduce the tax burden by approximately €585 million annually. The bill contains more than 40 items that are not part of an overall tax reform but single modifications to German tax law. The amendments would generally take effect January 1, 2012; some proposals would take effect retroactively from January 1, 2011.

The draft bill contains the following significant changes to German tax law:

- increase in the annual flat sum for employees (*Arbeitnehmer-Pauschbetrag*) from €920 to €1,000;
- option to file personal income tax declarations simultaneously for two subsequent tax years;
- simpler computation of the commuter's tax allowance;
- elimination of personal requirements for parents regarding the deduction of child care expenses;
- a reduced number of assessment options for spouses;
- a simplified assessment procedure because capital income taxed at source won't be considered in the calculation of several deductions;
- revised withholding tax procedure regarding dividend distributions of a cooperative;
- introduction of a free advance ruling for an object valued at up to €10,000;
- simplified documentation requirements for donations made after catastrophic events; and
- the option to electronically transmit notifications required under German real estate transfer tax law.

Most Important Changes

Increased Annual Lump Sum for Employment Expenses

Under the current income tax law, taxpayers receiving employment income are granted an annual lump sum of €920 as income-related expenses. That amount would be increased to €1,000 retroactively from January 1, 2011. The increase would be implemented in December 2011 by an adjustment item (*lohnsteuerlicher Ausgleichsbetrag*). The increase would help employees with low income-related expenses or when the expenses are borne by the employer. If the individual income-related expenses don't exceed the €1,000 limit, no verification would be needed for the increased lump sum.

Option to File Two-Year Declarations

Individual taxpayers could file their income tax declaration every second year instead of every calendar year. The due date for filing a two-year tax declaration would generally be May 31 following the second calendar year. The option could be exercised by individuals who receive no profit income. The tax assessment period would remain the calendar year. Thus, the income tax would still arise with the expiration of the calendar year. To avoid negative effects from the beginning of the interest period (which usually starts 15 months after the tax arises) for the first year filed, the interest period of the first year would not start before the interest period of the second year starts.

Schedule

The bill is scheduled for approval by the Bundesrat on July 8.

OGAW-IV-Implementation Bill

On May 27 the Bundesrat passed the OGAW-IV-Implementation Bill.

Overview

The bill incorporates into German law EU Directive 2009/65/EC of July 13, 2009,[2] on the coordination of laws and administrative provisions regarding undertakings for collective investment in transferable securities (UCITS). The goal of the bill is to increase the efficiency of collective investment undertakings, to amend investors' protection, and to increase cooperation with national supervisory bodies.

Withholding tax on the short sale of shares that are either kept in a collective depot/custodian account or in a depot account in which each share may be identified separately beyond the dividend ex-date will be changed to prevent abusive practices.

Under the German Real Estate Investment Trust Law, qualifying REITs are exempt from German corporation and trade tax. Besides being listed on a stock exchange, German REITs must meet minimum distribution, minimum share diversification, and minimum equity requirements. The deadline for the initial public offering to obtain the REIT status may be extended from four to five years.

For real estate transfers occurring after December 31, 2009, the German law to aid economic growth (Wachstumsbeschleunigungsgesetz) introduced an exemption for German real estate transfer tax regarding some intragroup restructurings. It will now be extended

[2]Official Journal of the EU No. L 302, Nov. 17, 2009, p. 32.

so that a partnership can be a dependent group entity. Under the new rule, a partnership is considered a dependent party if the controlling entity directly or indirectly holds more than 95 percent of the partnership's assets. The new rule will become effective retroactively for transfers taking place after December 31, 2009.

The bill will enter into force the day after it is published in the German official gazette. ◆

♦ *Sabine Demel, P+P Pöllath + Partners, Frankfurt*