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German Tax and Legal News

MOF publishes updated draft law to implement the EU anti-tax avoidance directive into German tax law

Anti-hybrid rules would be retroactively effective as from 1 January 2020; low-taxation threshold under CFC rules would not be reduced.

On 24 March 2021, the German government published an updated version of the draft "ATAD implementation law" regarding the implementation of the EU anti-tax avoidance directive (including provisions of ATAD I and ATAD II) into domestic German tax law. Based on the updated draft law proposal, which reflects only minor changes from the previous version of the draft law, the German anti-hybrid rules would be implemented with retroactive effect for expenses incurred on or after 1 January 2020. The updated proposal also includes provisions relating to the exit tax rules for individuals, the definition of a related person, and the controlled foreign company (CFC) rules (which do not include a reduction of the low-taxation threshold for purposes of the CFC rules).

The German Ministry of Finance (MOF) published the first draft version of the ATAD implementation law on 10 December 2019 (see GTLN dated 12 December 2019 and GTLN dated 23 December 2019), in light of the implementation deadline for ATAD II, which was 31 December 2019 for most provisions of the directive. However, the formal legislative process did not progress for the first version of the draft law due to political disagreement over some aspects of the draft law, and in January 2020 the European Commission initiated an infringement procedure against Germany for failure to implement the directive into its domestic law (INFR(2020)0027). In March 2020, another, slightly revised version of the draft law was published by the MOF, but again there was political disagreement and the legislative process was not continued.

As noted above, the updated draft of the ATAD implementation law published by the government on 24 March 2021 reflects only minor changes compared to the March 2020 version.

The draft anti-hybrid rules are largely unchanged, with some small changes addressing certain aspects of the exception from the denial of a deduction in the case of a dual inclusion of income and exceptions to the imported mismatch rule. Most notably, the provisions regarding the application of the anti-hybrid rules are largely unchanged, meaning that the rules still would apply to expenses incurred as from 1 January 2020, with certain exceptions for expenses under long-term contracts that cannot be changed without significant disadvantages. This would mean that rules that would be enacted in 2021 could disallow a deduction for expenses for fiscal years (FYs) that already have ended and where, in some cases, tax returns might already have been filed (although this is unlikely, given that the deadline for filing the annual corporate income tax return generally is 31 July of the year following the tax year and an extension of the deadline to the last day of February of the second year following the tax year typically is granted if a tax advisor is involved). While the intention of the legislature seems to be to ensure compliance with ATAD II, there are tensions with constitutional principles. If the draft law is passed as currently drafted, legal challenges to the rules likely will only be a matter of time.

The proposed changes to the Foreign Tax Act in the updated draft law no longer include the changes to the transfer pricing rules that had been included in an earlier version of the draft law since, in the meantime, such changes have been proposed as part of the "Draft law on the modernization of withholding tax relief" that was approved by the German government on 20 January 2021. Only the changes to the definition of a related person are still included in the updated draft of the ATAD implementation law.

The proposed changes to the exit tax rules for individuals, which mainly include the abolition of unlimited deferral of taxation for taxpayers that transfer their tax residence to another EU/European Economic Area member state, are still included in the updated draft law and would apply to individuals that transfer their tax residence from Germany on or after 1 January 2022. Compared to the initial release of the draft act at the end of 2019, which would have affected individuals leaving Germany in between Christmas and New Year's Eve 2019 with the intent to transfer their tax residence from Germany, there would be ample time for individuals planning to transfer their tax residence from Germany to benefit from the current unlimited deferral.

The reform of the CFC rules would follow the March 2020 version of the draft law, including the proposal to leave the current minimum threshold of an effective tax rate of 25%, below which "low taxation" is considered to exist, unchanged. The revised rules would apply for FYs of CFCs that start on or after 1 January 2022.

Further changes to the draft law could be made during the legislative process. However, given the upcoming federal elections in September 2021, there is not much cushion in the timeline to complete the legislative process. With the exception of the anti-hybrid rules, most of the rules in the updated draft law would apply only as from 2022. For the anti-hybrid rules, the retroactive application proposed by the updated version of the draft law would cause a variety of issues for the tax reporting and compliance process, and there are questions regarding its constitutionality.