


URL: <http://mobile.deloitte-tax-news.de/german-tax-legal-news/upper-house-proposes-anti-double-deduction-rule-for-partnership-structures.html>

 23.09.2016

German Tax and Legal News

Upper house proposes anti-double deduction rule for partnership structures

Proposal to be included in BEPS implementation act

On 23 September 2016, the upper house of the German parliament approved a comment regarding a draft tax law that includes measures based on the recommendations in the final reports issued under the OECD BEPS initiative, as well as the amendments to the EU administrative cooperation directive to introduce country-by-country reporting (see [GTLN dated June 9, 2016](#)).

In addition to the measures already proposed by the government, the upper house proposed in the comment some measures and also asked the lower house of parliament to take certain considerations into account in the further legislative process. The most noteworthy additional measure is an anti-double deduction rule targeted at partnership structures.

Under German tax law, interest expense incurred at the level of a partner of a partnership that are linked to the partnership business (e.g. interest expense related to the acquisition of the partnership interest) are treated as "special business expenses" and are deductible for tax purposes at the level of the partnership. If the partner is a nonresident, the partner becomes subject to limited German tax liability on its income from the partnership (a partnership is transparent for corporate income tax purposes). The interest expense that qualifies as a special business expense, therefore, is deductible for German tax purposes, but also may be simultaneously deductible for foreign tax purposes at the level of the partner. The measure proposed by the upper house would disallow a deduction for German tax purposes in such cases.

The materials provided by the upper house with the draft tax law refer to the OECD BEPS initiative and the joint task force created by the German government to implement the OECD recommendations. Although the upper house stated that the proposed measure should be limited to partnership structures and that the right to implement a general anti-double dip rule should be reserved to the joint task force, the upper house considers there to be an urgent need to implement the proposed rule since the targeted partnership structures are widespread and the possibility for a double deduction should not be acceptable.

In addition to the anti-double dip rule, the upper house asked the lower house to consider a more restrictive approach towards certain IP structures. The government's original proposal would allow certain IP structures that are based on using a foreign partnership as the holder of the IP to benefit from an exemption for trade tax purposes only if there are sufficient substance and activities at the level of the IP partnership. The upper house now has recommended eliminating the possibility to qualify for an exemption for trade tax purposes even if sufficient substance and activities are present.

There is a realistic possibility that the proposed rules will be introduced.

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