Germany considers proposal for new anti-hybrid rule and other amendments

On 24 October 2014, the Finance Committee of the German State Council (Bundesrat - the German Upper House) approved a recommendation to include several measures, including a new anti-hybrid rule, in a currently ongoing legislative process (Law Concerning the Adaption of the General Tax Code to the European Customs Codex and Other Tax Law Amendments).

This Alert summarizes the measures likely to be of relevance for international investors into Germany.

Deductions/hybrid mismatch rules

The measures include an anti-hybrid rule that would essentially deny a deduction to the extent an expense is not included as income in the taxable base of the direct or indirect recipient or is exempt at the level of the direct or indirect recipient due to a mismatch in the debt vs. equity classification of the legal construct which is underlying the payment. Also, expenses shall only be deductible to the extent they do not reduce taxable basis in another country. The proposed rule shall apply for all fiscal years ending after the official publication date for the finalized act. Hence, if this became law as part of the current legislative proposal, it could still apply to 2014 for calendar year taxpayers.

Interestingly, the Finance Committee of the Bundesrat justifies its proposal as in line with the Organisation of Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) current process, as documented in the draft OECD recommendations regarding Action Item 2 (Hybrid mismatches), issued in September of this year.1 It remains to be seen whether the German Government will follow this proposal. So far, the official position in Berlin has been to adopt national law changes implementing OECD recommendations triggered by the BEPS review process only after the final OECD recommendations are released, i.e., at the earliest at the end of 2015.
Other considerations regarding the proposal include:

- Contrary to the OECD recommendation for addressing the Action Item 2 hybrid mismatches, the proposed rule's scope is not restricted to hybrid arrangements with related parties. This raises questions on how taxpayers can document compliance with the rule, even more so, as the rule would not only look at the direct recipient of income.

- The Finance Committee specifically mentions German-inbound planning using German partnerships with foreign partners as a reason for its proposal to deny a double deduction of expenses.

**Capital gains on portfolio share investments**

Another measure is the full taxation of capital gains realized on the disposition of portfolio (less than 10%) corporate shareholdings. Currently only dividends are fully taxable for a corporate shareholder with such portfolio shareholdings, while capital gains are effectively 95% tax exempt.

**Change in ownership rules**

Beneficial for taxpayers would be the proposed revision of the so-called “group exemption” from the German change in ownership rule, according to which tax loss attributes are not forfeited upon a direct or indirect shareholder change, if the shareholder change occurs within a 100% controlled group. The revised wording would now also allow a transfer to or from a 100% group shareholder and this ultimate shareholder could also be an individual or a partnership.

**Group reorganizations**

The finance committee proposes a limitation regarding non-share considerations that a receiving entity (transferee) can provide to the transferor in certain group reorganizations (i.e., transfer of qualifying assets against issuance of new shares). For tax free transfers, the non-share consideration (e.g., issuance of a shareholder loan) would be limited to 10% of the contributed assets’ tax book values.

**Real estate transfer tax**

A retroactive change to the real estate transfer tax act is proposed, whereby (contrary to recent case law) any 95% or greater change in the indirect corporate ownership chain above a real estate-owning partnership triggers the tax, regardless whether the ultimate ownership changes or not.

**Offshore Industry Activities**

Extension of the definition of taxable activities in Germany to all activities carried out on the German continental shelf as well as in its exclusive economic zone, as opposed to the current situation where taxability is limited to the extraction of natural resources or to the production or use of energy in these offshore situations.

The next steps are that first the Bundesrat must adopt these recommendations (a decision is expected in early November). Whether the government will then still incorporate some of the proposed changes in the current legislative process, and whether this process would be finalized prior to 2014 year end cannot be predicted with certainty.

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**Endnote**

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