

LIMITED DEDUCTION OF OPERATING EXPENSES IN THE CASE OF HYBRID STRUCTURES

After a long political struggle, the German legislator passed the so-called ATAD Implementation Act which was published in the Federal Law Gazette on June 30, 2021 (BGBl. I 2021, p. 2035). The new regulation aims to transpose the EU requirements of the „Anti Tax Avoidance Directive“ (ATAD) into national law. This means that there is now a comprehensive regulation on the deduction of operating expenses in the case of hybrid mismatch arrangements in the Income Tax Act. The deduction limitation rule applies retroactively to expenses incurred after December 31, 2019. This affects in particular financial instruments or companies that are treated differently for tax purposes in different countries.

OVERVIEW OF THE NEW REGULATION

The hybrid mismatch provisions in Section 4k of the German Income Tax Act apply to operating expenses for cross-border situations involving

- › persons related for tax purposes, e.g. in the case of an equity interest of at least 25%
- › an entity and its foreign permanent establishment, or
- › structured arrangements, e.g. if the intended tax advantage has been included in the contractual agreements.

DEDUCTION/NON-INCLUSION

The new Act relates principally to payments made in connection with a hybrid financial instrument. These expenses are excluded from the deduction of operating expenses in Germany by the new rules if the income corresponding to the expenses is not taxed or is taxed at a lower rate abroad due to a tax qualification or allocation of the capital assets that differs from German law. Furthermore, the deduction of operating expenses in Germany is denied if income corresponding to the

expenses is not taxed or is taxed at a lower rate abroad due to the hybrid structure of a company or due to an assessment of (fictitious) cross-border service relationships between the parent company and the permanent establishment (so-called dealings) that deviates from German tax law. In addition, the deduction of business expenses is prohibited if the income corresponding to the expenses is not subject to actual taxation in any country due to a mismatched tax allocation or attribution.

DOUBLE DEDUCTION

The new provision is also intended to prohibit any double deduction of business expenses to the extent that the same payment qualifies as tax-deductible in another state. However, the prohibition concerning the deduction of business expenses does not apply if the expenses taken into account in more than one country are offset by income of the same taxpayer that is subject to actual taxation both in Germany and the other country.

IMPORTED MISMATCH

Finally, the deduction of business expenses is also denied in cases of a so-called imported mismatch. This is assumed to be the case if the income directly or indirectly resulting from the domestic expenses is related to expenses abroad, the deduction of which would be denied to the creditor, a third-party creditor or other person if the preceding principles were applied accordingly.

TREATY OVERRIDE

The restriction on the deduction of business expenses applies regardless of the provisions of the double taxation treaties. Affected companies can therefore not claim treaty protection.

FIRST-TIME APPLICATION

Expenses incurred after December 31, 2019 are covered by the business expense deduction restriction under Section 4k of the German Income Tax Act. If the expenses were already incurred before January 1, 2020, they are only deemed to have incurred after December 31, 2019 to the extent they are based on a continuing obligation and to the extent they could have been avoided from January 1, 2020 without significant disadvantage. A significant disadvantage is assumed if the costs associated with the avoidance of the expenses exceed the tax benefits. However, the causation of the expenses before January 1, 2020 is not applicable if the continuing obligation is materially changed after December 31, 2019.

TYPICAL CASES

HYBRID FINANCIAL INSTRUMENT

A German group company grants jouissance rights to a sister corporation domiciled abroad. These rights are classified similar to obligations from a domestic perspective and the related payments to the sister corporation represent interest expense. The deduction of operating expenses is denied if the jouissance rights are treated similar to equity investments in the other country and if the payments are (partially) tax-exempt as dividends for the sister corporation.

HYBRID ENTITY

The domestic resident GmbH & Co. KG (German limited partnership with a limited liability company as general partner) opts for domestic corporate income taxation for 2022. A limited partner resident abroad participates in the KG (limited partnership) and receives a managing director's salary. Abroad, the company is still treated as fiscally transparent and the managing director's salary qualifies as a share in profits that is not taxed abroad due to the tax exemption for permanent establishment profits according to the double taxation treaty. In Germany, the GmbH & Co. KG is therefore denied the deduction of operating expenses for the managing director's salary.

WHAT IS TO BE DONE?

There is a need for action in regard to cross-border situations with related parties who are potentially treated differently for tax purposes in Germany and abroad. In these cases, each situation should be examined in the short term as to whether the deduction of operating expenses is no longer possible or only possible to a limited extent due to the new regulation. The complexity of the regulation with its numerous exceptions regularly requires a detailed examination of the individual case.

Such an examination must already be carried out as part of the preparation of the tax returns for 2020, as the new regulation will generally already apply for the 2020 tax year.

Particularly in the case of continuing obligations, it must be examined from what point onwards the limitation on the deduction of operating expenses applies. Here, particular attention should be paid as to whether the expenses can be avoided in the future without significant disadvantages.

CONTACT



The contact persons at Ebner Stolz you are familiar with will be happy to answer any questions you may have on the deduction of business expenses in the case of hybrid arrangements. In addition, you are also welcome to contact our experts in international tax law.

Publisher

Ebner Stolz Mönning Bachem
Wirtschaftsprüfer Steuerberater Rechtsanwälte Partnerschaft mbH
www.ebnerstolz.de

Law current as of 16 October 2021

Editorial

Dr. Ulrike Höreth, Tel. +49 711 2049-1371
Brigitte Stelzer, Tel. +49 711 2049-1535

This publication contains only general information that is not suitable as a basis of decisions in specific cases. The publisher and the authors do not guarantee the accuracy and completeness of the information.

Should readers consider information contained herein to be relevant, it is incumbent on them or their advisors to check the veracity of the information; the information set out above is no substitute for competent advice in individual cases. For more information please contact the publisher.

The information is subject to copyright protection. A copy may be saved for private purposes or the document may be forwarded for private purposes (only in full). All types of commercial use, especially the printing of this document (or extracts therefrom) in other newsletters or publication on websites, require the written permission of the publisher.