

•• Germany

The image features a solid dark blue background. In the upper left corner, the word "Germany" is written in a white, sans-serif font, preceded by two small white circles. The right side of the image is dominated by several sweeping, curved lines that originate from the bottom left and curve upwards and to the right. These lines are rendered in various shades of light blue and white, creating a sense of motion and depth. The lines overlap and intersect, forming a dynamic, abstract composition.

## General

### 1. What are the recent tax developments in your country which are relevant for M&A deals?

Germany has recently seen some legislative developments with relevance for M&A deals. The tax legislation amended the Reorganisation Tax Act (RTA) by tightening the conditions for the tax neutrality of hive-downs and share-for-share exchanges. Their tax neutrality in general requires that the transferring person receives as consideration new shares in the receiving entity. Other considerations by the receiving entity in addition to new shares (e.g. cash, shareholder loans) are permitted. However, the legislation requires that the fair value of such other considerations must not amount to more than (a) 25% of the book value of the contributed business assets or (b) EUR 500k (the amount must not exceed the book value of the contributed assets).

Moreover, regarding the loss forfeit rules, the tax legislation extended the beneficial group relief to further intra-group transactions (see no. 8 below).

M&A deals are also affected by amendments of the Real Estate Transfer Tax (RETT) Act. With respect to the transfer of interests in German real estate holding partnerships, RETT will in principle be triggered if at least 95% of the interests are directly or indirectly transferred within 5 years. With respect to indirect transfers, the German Federal Fiscal Court ruled that 100% of the shares of a corporation that is a partner of the real estate holding partnership have to be transferred in order to assume a tax-relevant transaction of the partnership interest. The legislature tightened this taxpayer-friendly jurisprudence by introducing a provision under which a transfer of at least 95% of the shares in such a corporation would be sufficient to trigger RETT. Furthermore, the legislature increased for many cases the tax base for RETT purposes by introducing new rules for determining the fair value of real estate, thereby following a judgment of the German Federal Constitutional Court.

Finally, it is important to note that the envisaged tightening of the rules dealing with the tax-exemption of capital gains deriving from the disposal of shares in corporations by corporations (i.e. a 10% minimum shareholding criteria) has not been introduced yet and is currently not included in any tax bill. However, it cannot be ruled out that the restriction will be enacted at a later stage.

### 2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (Action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive?

#### BEPS

Germany generally supports the BEPS actions. Many proposals have already been implemented in German tax law (e.g. an interest barrier rule, action 4). At the moment (February 2016), no general legislative proposal in regard to BEPS actions is available. It seems likely that in particular BEPS actions 2 (hybrid mismatch arrangements) and 13 (country-by-country reporting) will be implemented in German law. In regard to hybrid mismatches, a previous law proposal contained provisions aimed at preventing a no-taxation or double-dip situation. It is to be assumed that a regulation will be implemented on the basis of this proposal.

As far as action 6 is concerned, German national law and many double tax treaties (DTT) already include anti-treaty-shopping, subject-to-tax and switch-over clauses. Certain DTTs also contain limitation-on-benefits clauses. It is to be assumed that further adjustments of German DTTs with regard to a limitation-on-benefit clause and a principle purpose test could be made as part of the implementation of a multilateral instrument (action 15). The negotiations concerning this multilateral instrument should be concluded by the end of 2016.

The EU has published a draft directive aimed at implementing the core BEPS measures across the EU. This is expected to influence further legislative measures in Germany.

## Parent-Subsidiary Directive

The recent amendments of the Parent-Subsidiary Directive in July 2014 (introducing subject-to-tax clause and correspondence principle) and January 2015 (introducing a general anti-abuse clause) were in principle enacted in German tax law.

### 3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

#### a. Share deal

##### Buyer perspective

In a share deal, no step-up of assets in the target company is possible. Further, the buyer acquires all tax risks from prior years associated with the company's shares and therefore requests tax guarantees/indemnity from the seller. Share acquisitions are generally not subject to VAT (see below). If the target company owns German real estate with considerable value, a share deal might enable the buyer to mitigate or even avoid RETT (see no. 14 below). There are various options available for the buyer to achieve a debt-push down (see no. 7 below). Whether interest expense is deductible depends on the general requirements (see no. 6 below).

##### Seller perspective

From a corporate seller's perspective, the main advantage of a share deal is that the capital gain deriving from the disposal of shares is in principle 95% tax-exempt. However, capital losses from share deals are not tax-deductible at all. Losses carried forward and current losses up to the transfer date might be forfeited under the loss forfeiture rules (unless certain requirements are fulfilled). Share transfers are generally VAT-exempt. Depending on the VAT situation of the seller and the purchaser, the seller can opt for regular VAT in order to improve the deductibility of input VAT on transaction costs.

#### b. Asset deal

##### Buyer perspective

An asset deal gives the buyer the possibility to step up the acquired assets, including goodwill, up to the acquisition price. The subsequent depreciation results in lower tax burdens for the buyer in the future. In an asset deal, most of the tax risks from former years remain with the seller. However, if the asset deal qualifies as a transfer of a going concern (meaning the transfer of the whole business), there is a special regulation that the acquirer has to take on some secondary liability for certain taxes resulting from the pre-acquisition period.

Debt push-down is not an issue as financing can be easily provided to the acquiring company. Deductibility of interest expense depends on the general requirements (see no. 6 below). Furthermore, the acquisition of assets is generally not exempt from VAT (unless the assets qualify as a going concern). This has to be carefully considered if the input VAT is not fully deductible.

Please note that the acquisition of a partnership interest is treated like an asset deal for German tax purposes. Therefore there is a step-up of the value of the assets for the buyer when acquiring partnership interests. Depreciations of the stepped-up assets (shown in a supplementary balance sheet) are allocated directly to the acquiring partner.

##### Seller perspective

The asset deal is in principle a taxable event. Capital gains could be offset against existing losses and loss carry-forwards of the seller. In this context the seller has to take into account Germany's minimum taxation rules. These rules allow the deduction only of loss carry-forwards in a fiscal year in the amount of EUR 1 million plus 60% of the income exceeding EUR 1 million. The seller usually retains all tax risks from prior years associated with the business assets. Capital losses from an asset deal are in principle tax-deductible.

## II. Buy-side

### 4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

German tax law does in principle not provide for a tax-neutral step-up of the value of tangible or intangible assets in a share deal. Various options (e.g. sale, merger) are available to achieve a taxable step-up of the assets after the share deal. In this context a tax benefit could be achieved only if existing losses or loss carry-forwards can neutralise the taxable capital gain. However, minimum taxation rules have to be considered in cases where the taxable profit from the contribution exceeds EUR 1 million and no sufficient losses of the current year are available (see no. 3b) above).

### 5. What are in particular rules of depreciation of goodwill in your country?

German tax law allows a straight-line depreciation of goodwill over 15 years. For German GAAP purposes, however, the depreciation period of goodwill is generally 5 years.

### 6. Are there any limitations to the deductibility of interest on borrowings?

#### Arm's length principle

The interest rate on borrowings from shareholders or related persons must comply with arm's length principles. This also requires that financing agreements are concluded in writing and beforehand in order to prevent the tax authorities from denying the interest deductibility.

#### Interest barrier rules

According to the German interest barrier rules, a taxpayer is able to immediately deduct net interest expenses (interest expenses minus interest income) only up to 30% of the taxable earnings before interest, taxes, depreciation and amortisation (taxable EBITDA). The tax EBITDA only includes taxable income and thus does not necessarily match with the GAAP EBITDA. The interest barrier rules apply to all interest and not only to interest on intra-group loans. The interest barrier rules allow EBITDA carry-forwards (broadly speaking, unused EBITDA in 1 year can be used to achieve an interest deduction in future years) and interest carryforwards (non-deductible interest might be deductible in future years if there is sufficient EBITDA in such a year). Interest carryforwards are subject to the change-of-ownership rules (see no. 8); EBITDA carryforwards elapse after 5 years.

The interest barrier rules do not apply if 1 of the following conditions is met:

- ❖ The annual interest burden (interest expenses minus interest income) is less than EUR 3 million (exemption limit, no allowance),
- ❖ The taxpayer is not part of a group of companies and the interest expense paid to a material shareholder or a related party or a back-to-back lender does not exceed 10% of the company's total net interest expense or
- ❖ The taxpayer proves that the borrower's equity ratio is at least as high as the world-wide group's equity ratio. It is tolerable if the German entity's equity ratio is 2 percentage points below the group's ratio. This escape clause applies only if the taxpayer or any other group company is not shareholder-financed to a harmful extent; that is, if the taxpayer or any group company pays more than 10% of its interest expense to a material shareholder or related party outside the group or to a third party secured by the material shareholder or related party.

#### Add-back for trade tax purposes

25% of the interest expenses have to be added back for trade tax purposes (unless an amount of EUR 100,000 is not exceeded).

## 7. What are usual strategies to push-down the debt on acquisitions?

Various options are available to achieve a debt-push down. 1 is to implement a tax group (Organschaft) between the debt-financed German acquisition vehicle and the target company. Such a tax group allows for a settlement of profits of the target company and the losses of the acquisition vehicle resulting from the financing expenses. Alternatively, the acquisition vehicle and the target company can be merged. Leveraged distributions or repayments of (free) capital reserves of the target company are other potential options. When determining the level of debt financing, the German interest barrier rules have to be considered. The German capital maintenance rules also have to be kept in mind.

## 8. Are losses of the target company(ies) available after an acquisition is made?

The direct or indirect transfer (or a similar transaction, such as a capital increase or an internal group restructuring) of more than 25% or 50% of the shares in a loss company to any shareholder or a group of shareholders with similar objectives within a 5-year period leads to a partial or complete forfeiture of current tax losses and tax loss carry-forwards. The law provides for several options to avoid the forfeiture of losses and loss carry-forwards:

### Intra-group escape (amended in 2015)

The acquisition of shares in principle no longer results in the loss (or partial loss) of losses and loss carry-forwards if the same taxpayer indirectly or directly holds 100% of the shares in both the transferring and the acquiring entity, the acquirer indirectly or directly holds 100% in the shares of the transferring entity, or the seller indirectly or directly holds 100% in the acquiring entity. Intra-group reorganisations that fulfill these (strict) requirements can therefore be carried out without the loss of losses and loss carry-forwards.

### Hidden-reserve escape

In addition, a corporation's unused tax losses are preserved to the extent they are compensated for by hidden reserves that have been built into those business assets of the corporation that are subject to German taxation. If only between 25% and 50% of shares in the corporation are sold, the corresponding portion of hidden reserves is considered. The hidden reserves are evaluated by comparing the portion of the equity of the shareholder(s) that corresponds to the portion of the transferred shares with the fair market value of these shares. In a sale of more than 50% of the shares, the entire hidden reserves can be taken into account and be compared with the fair value of all shares.

### Restructuring escape

The restructuring escape rule stipulates that losses and loss carry-forwards are not affected by changes in ownership of a corporation if the change is part of a restructuring measure. However, this rule is not applicable at the moment as it has been classified as forbidden state aid by the European Commission. Legal proceedings by Germany against the decision of the European Commission in front of the European Court of Justice were (for formal reasons) not successful. However, lawsuits of companies are pending.

## 9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax, etc.)?

Germany does not impose any stamp duties or transfer tax on share transfers. However, if the target company owns German real estate, Germany levies under certain requirements RETT on a specially assessed property value (see no. 14 below).

## 10. Are there any restrictions on the deductibility of acquisition costs?

Acquisition costs are generally not deductible but have to be depreciated over the average useful life (if applicable; e.g. shares in corporations are not subject to depreciation). Incidental acquisition costs (e.g. for legal/tax advice) usually have to be allocated to the acquired assets and are – in principle – not immediately deductible but part of the pro rata depreciation (if applicable). An immediate deduction of such costs is possible if it can be proven that there is no economic connection between the acquired assets/shares and the corresponding costs. This is generally difficult to achieve. Costs in regard to failed acquisitions are in principle immediately deductible. RETT paid in an asset deal has to be capitalised whereas RETT triggered in a share deal transaction is in principle immediately deductible.

## 11. Can VAT (if applicable) be recovered on acquisition costs?

A VAT recovery requires that the person that wants to claim input VAT has to qualify as an entrepreneur for VAT purposes. It is further required that the acquired assets will be used for transactions subject to VAT. If VAT cannot be recovered on acquisition costs, it would increase the acquisition costs and be part of the pro rata depreciation (if applicable).

## 12. Are there any particular issues to consider in the acquisition by foreign companies (for example non-resident taxation rules/substance rules and tax efficient exit routes)?

A foreign (non-German) acquiring company is subject to limited tax liability in Germany if it generates income from German sources. German sources are for instance given if (i) shares in a German entity with registered seat and/or place of management in Germany, (ii) real estate located in Germany or (iii) assets belonging to a German permanent establishment are acquired.

When a foreign company acquires shares in a German entity, withholding tax (WHT) of 25% (26.375% including solidarity surcharge of 5.5%) is generally levied on, for example, dividend, interest or royalty payments by the German entity to its foreign shareholder. An applicable DTT or EU directive (e.g. Interest and License Fee Directive, Parent-Subsidiary Directive) might fully or partially reduce the German WHT burden. The German entity may abstain from WHT deduction only if an exemption certificate is issued by the German Federal Central Tax Office prior to the relevant payment. A reduction or refund (without a prior exemption certificate) of German WHT is subject to the fulfillment of certain requirements concerning the activity and substance of the direct or indirect foreign shareholder of the German entity.

Please be aware that the German 95% tax exemption for dividend income is available for German and foreign shareholders only if the shareholding in the German company amounts to at least 10% for corporate income tax purposes and 15 % for trade tax purposes (at the beginning of the fiscal year of the subsidiary in question).

## 13. Can the group reorganise after the acquisition in a tax neutral environment through mergers or a tax group?

There are various options to reorganise a group after the acquisition in a tax-neutral environment.

### Options for tax-neutral reorganisation measures

In particular the RTA provides for tax-neutral reorganisations such as mergers, spin-offs, hive-downs, conversions, contributions of shares or specific business assets. The full or partial tax neutrality for the transferring entity in principle requires that (i) Germany retains the right to tax a capital gain regarding the assets transferred, (ii) the transferring entity only receives new shares in the receiving entity (or limited other considerations, see above), and (iii) the relevant entity files an application for tax neutrality with the competent tax office. If these requirements are met the transferring entity may recognise the assets at tax book value thereby avoiding a capital gain. These rules are also applicable in cross-border reorganisation measures.

German tax law also provides for structuring options outside the Reorganisation Tax Act. For instance, the assets of a partnership can be transferred to its sole remaining partner in a tax-neutral way.

### Tax group

An income tax group can in principle be implemented between the acquiring entity and the target company. The main advantage of an income tax group is that profits and losses of the entities belonging to it are consolidated at the level of the parent company (controlling entity). Further benefits might be available (e.g. regarding the interest barrier rules, no 5% taxation of dividend income). The subsidiary (controlled entity) still qualifies as a taxable entity and has to file (annual) corporate income tax returns. Certain requirements for an income tax group must be met:

- ❖ The controlling entity must hold the majority of the voting rights in the controlled entity from the beginning of its financial year.
- ❖ The controlling entity and the controlled entity must enter into a profit and loss transfer agreement for at least 5 years. The agreement must be consistently applied throughout the term of the agreement.

- ❖ The controlled entity must be a corporation having its place of management in Germany and its registered seat in an EU/EEA member state.
- ❖ The investment in the controlled entity must – from a functional point of view – be attributable to a German permanent establishment (PE) of the controlling entity and the income of the PE be subject to German tax and not be exempt under a DTT.

In particular in M&A deals with controlled entities a clear termination of the profit and loss transfer agreement has to be ensured. The SPA should provide for a reasonable allocation of tax risks before the transfer date. An acquisition can be structured in a way that the tax group with the selling controlling entity exists until the transfer date and a new tax group with the buyer starts as of the transfer date (e.g. by implementing short fiscal years).

Different rules apply to VAT groups for which a profit and loss transfer agreement is not required. Rather, it is necessary that the controlled entity (which could also be a partnership) is financially (majority of voting rights), economically and organisationally (actual control of the controlling entity in the controlled entity) integrated.

#### **14. Is there any particular issue to consider in case of companies of which main assets are real estate?**

The main issue to consider when acquiring companies whose main assets comprise German real estate is that Germany levies RETT on the direct or indirect transfer of such real estate. The tax rates vary between 3.5% and 6.5% depending on the federal state in which the real estate is located. In an asset deal, RETT is always triggered (the purchase price is the assessment base; no avoidance strategies are available).

In a share deal regarding partnership interests, RETT is basically levied if at least 95% of the partnership interests are transferred within a period of 5 years. A transfer of shares in corporations triggers RETT only if a buyer (or a RETT group) acquires at least 95% of the shares. The tax base is in principle the fair value of the real estate. RETT can be avoided by, for example, selling only 94.9% to a single purchaser and having the shareholder or a third party retain the remaining 5.1% shareholding. RETT relief might be available for certain reorganisation measures (e.g. mergers, spin-offs, hive-downs or contributions and share-for-share exchanges). This requires, among other things, that the controlling company holds indirectly or directly at least 95% of the shares in the controlled company involved in the reorganisation within 5 years prior to the relevant transaction and for at least 5 years after it.

An increasing number of German DTTs allocate the right to tax a capital gain deriving from the disposal of shares to the state of residence of the target company if most of its assets comprise real estate (see also Art. 13(4) of the OECD Model Convention).

### **III. Sell-side**

#### **15. How are capital gains taxed in your country? Is there any participation exemption regime available?**

In principle, capital gains from the disposal of German assets (including partnership interest) are subject to German income taxation.

An important exemption is the capital gain deriving from the disposal of shares in a corporation by a corporation. Under German tax law, 95% of such a capital gain is in principle tax-exempt irrespective of any minimum shareholding or holding period. In the case of an individual person, the taxation of the capital gain from the disposal of shares depends on (i) the shareholding percentage, and (ii) whether the share is held as private property or as business property. For shareholdings of 1% or more, 40% of the capital gain is tax-exempt and 60% is taxable at the individual income rate (this ratio also applies to expenses in connection with the transaction). The same treatment applies (irrespective of the holding percentage) if the shares belong to a business or trade of the individual. In all other cases a capital gain is taxed at a beneficial lump-sum tax rate of 26.375% (costs are not tax-deductible at all). If a partnership generates a capital gain from the disposal of shares, the applicable tax rule basically depends on the tax status of the partner (being a corporation or an individual person).



## 16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

Under certain conditions, there are some tax advantages to reinvesting proceeds from an asset sale in cases where real estate or buildings are sold and new real estate and buildings are (intended to be) acquired. The capital gain from the sale is not immediately subject to income taxation but can be deducted from the acquisition costs of newly acquired assets. As a result, the depreciation base of the newly acquired assets is reduced. If no new assets are to be immediately acquired, the capital gain can be parked tax-free as reserve and deducted from new acquisitions within the next 4 or 66 years (as the case may be). However, if no new acquisitions take place in the relevant period of time, the reserve has to be dissolved, leading to retroactive taxation. Individuals selling shares can benefit from rules similar to those de-scribed for real estate (applicable to capital gains of up to EUR 500,000). There is no tax ad-vantage to reinvesting sale proceeds from a share deal made by corporations.

## 17. Are there any local substance requirements for holding/finance companies?

The 95% exemption for capital gains and profit distributions (see above) are not available if the shares that are sold or that generate profit distributions are held in the trading book of a bank or financial services company. The same applies for shares that are acquired by a finance company with the intention of achieving a short-term trading profit (e.g. a holding or leasing company).

Foreign holding companies need to prove certain substance requirements in order to benefit from WHT relief under a DTT or German tax rules (see no. 12).

Holding companies do not qualify as entrepreneurs for VAT purposes if they are mere finance holdings. In this case no (full) input VAT deduction would be available. A different VAT treatment would apply if a holding company carries out management services with regard to its subsidiaries for which it receives an arm's-length remuneration.

## Your Taxand contact for further queries is:

### Germany



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