

## Energy Overview

Germany has set itself the goal of becoming climate-neutral by 2045. This goal is to be achieved, among others, by moving away from fossil fuels and expanding renewable energy production.

- ❖ Renewable energies accounted for 56% of the electricity mix in 2023. Wind power was the most important source of energy for electricity generation in Germany in 2023 with a share of 31 %.
- ❖ The aim is that renewable energies cover at least 80% of electricity consumption in Germany by 2030.
- ❖ The second most important energy source for electricity generation in Germany in 2023 was coal with a share of 26%. Nevertheless, coal-fired power generation is to be phased out by 2038.
- ❖ Nuclear power was phased out in 2023 in Germany.

To meet its energy demand, Germany imports more than two thirds of its fossil fuels from abroad.

- ❖ The country is therefore dependent on countries and regions such as the Middle East. The expansion of renewables also serves to reduce this dependence.
- ❖ However, Germany also has its own resources from which energy can be obtained. These deposits consist primarily of brown coal and hard coal. There are also deposits of natural gas and crude oil and small quantities of uranium.

Hydrogen is seen as the energy source of the future. It is expected to play a decisive role in replacing natural gas, oil and coal.

- ❖ Among other things, the National Hydrogen Strategy ("Nationale Wasserstoffstrategie") describes the expansion of a hydrogen infrastructure and sets government guidelines for the production, transport and use of hydrogen.
- ❖ It is planned that the German government will invest €18.6 billion in the development of the hydrogen industry between 2024 and 2027.

The war in Ukraine is affecting energy markets worldwide. The consequences of the war for Germany range from extremely high energy prices to efforts to ensure energy security and diversify energy sources.

- ❖ Gas deliveries from Russia via Nord Stream 1 fell drastically in 2022 and finally dropped to 0 TWh at the beginning of September 2022.
- ❖ The most important sources of gas imported to Germany in 2022 were Norway, the Netherlands and Belgium, with a combined share of 68 %.
- ❖ Electricity and gas prices rose sharply as a result of the Ukraine war.

E-cars are set to play a central role in achieving the goal of climate neutrality by 2050 as part of the European Green Deal. From 2035, no new diesel or petrol cars may be registered in the EU.

- ❖ In Germany, the share of e-cars in total car sales has increased 10 times since the start of the Covid pandemic. This is partly due to government purchase incentives, such as the environmental bonus.
- ❖ The share of e-cars in the passenger cars in Germany has risen continuously in recent years and stood at around 3.9 % in 2023. According to recent forecasts, the share of e-cars could be 11.1% by 2025 and 24.4% by 2030.
- ❖ The German government has set a target of at least 15 million e-cars on the road by 2030. In order to achieve this goal, a well-developed charging infrastructure must be in place. Furthermore, the electricity grid must be able to bear the higher loads caused by the charging infrastructure. This requires capital-intensive investments.

In 2022 the German government showed (contrary to the public expectations) that it is in a position to react adequately to critical events at an appropriate pace and that important decisions can be made fast. The following was decided:

- ❖ A total of 6.9 GW of hard coal and lignite-fired power plant capacity returned to the electricity market for a limited period during the declaration of emergency.
- ❖ The operating life of the 3 remaining nuclear power plants was extended until April 2023.
- ❖ The first German floating LNG terminal in Wilhelmshaven went into operation in December 2022. In January and March 2023, two more floating LNG terminals followed.

## Tax Overview

Germany levies income tax on the worldwide income of individuals who are either resident or domiciled in Germany (unlimited income tax liability). Natural persons who are neither residents nor domiciled in Germany are subject to limited income tax liability if they have domestic income (limited income tax liability).

- ❖ The income tax rate is progressive, depending on the income.
- ❖ The maximum income tax rate is 45%. Under certain circumstances, the solidarity surcharge (5.5% on income tax) is also levied.

Furthermore, Germany levies corporation tax on corporations that have their management or registered office in Germany (unlimited corporation tax liability). Similar to income tax, corporations that have neither their registered office nor their management in Germany are subject to limited corporation tax on their domestic income (limited corporation tax liability).



- ❖ The corporation tax rate is 15% plus 5.5% solidarity surcharge (on the corporate taxes).

Trade tax is also imposed in Germany. Every standing commercial enterprise is subject to this tax if it is operated in Germany. The activity of a corporation is always and fully considered a commercial enterprise.

- ❖ The tax base for trade tax is the trade income. Trade income is defined as the profit from business operations determined in accordance with tax laws (German Income Tax or Corporation Tax Act), adjusted for additions and deductions.
- ❖ The trade tax rate depends on the municipality levying it. On average, it is around 14%. Trade tax is payable in addition to corporation tax, so that the combined corporation tax and trade tax rate is approximately 30%.
- ❖ Trade tax can be offset against income tax (but not against corporate income tax).

If distributions are made to residents or non-residents, they are subject to a withholding tax, so that equivalence is achieved in the taxation of corporations and partnerships. Depending on the double tax treaty, an exemption certificate would provide for not paying withholding taxes.

Besides, there is a withholding tax on domestic income earned by, among others, license grantors. In addition, income from capital is also subject withholding tax plus a solidarity surcharge.

Germany also levies a VAT. It applies, among others, to supplies and other services that an entrepreneur carries out in Germany in return for payment as part of his business.

- ❖ The VAT rate is either 19% or 7%.

## Taxation of Energy Projects

In Germany, energy projects are typically carried out either within a corporation (e.g. GmbH, AG) or a partnership (e.g. KG, OHG).

- ❖ A corporation and a partnership differ, among other things, in terms of their scope of liability and their taxation. According to the German Corporate Income Tax Act (KStG), the corporation itself is the tax debtor for the corporation tax (non-transparent). The income is also determined at the level of the corporation.
- ❖ In contrast, partnerships are fiscally transparent for German income tax purposes. Although the income of a partnership is also determined at company level, the partners are liable for tax according to the German Income Tax Act (EStG).

If an investor wants to invest in an energy project (e.g. wind farm or solar park), he has the choice between an asset deal and a share deal. These differ, among other things, in their ongoing tax treatment as well as in the treatment of profits that arise in the event of a sale.

- ❖ In case of an asset deal, the investor must recognise the acquired assets (and also the liabilities) in the balance sheet with realisation of hidden reserves. This can result in increased tax depreciation and consequently lower taxable income. A sale is fully subject to tax.
- ❖ In case of a share deal, the shares are not subject to depreciation and can thus not reduce taxable income. However, the sale of the shares - if the shares are held via a German holding company, for example - is effectively 95% tax-free. 5% of the capital gain is deemed to be non-deductible operating expenses and is subject to taxation.
- ❖ Whether an energy project should be realised via an asset deal or a share deal cannot be assessed in general terms. This requires a case-by-case assessment.

Usually, energy projects are very capital intensive. That's why financing is typically an issue of high importance. Especially the capital structure - the mixture of debt and equity - of a company must be determined by the company as the cost of debt and the cost of equity are treated differently for tax purposes.

- ❖ In general terms, interest on debt incurred by the company realising the energy project will be deductible in computing income for tax purposes, while equity distributions (e.g., dividends on shares of a project corporation) are non-deductible by the company.
- ❖ The interest deduction is limited by the so-called interest barrier ("Zinsschranke"). According to this regulation, interest expenses of a company are deductible in the amount of the interest income and beyond that only up to the amount of the offsetable EBITDA, which is equivalent to 30 % of the EBITDA. Furthermore, the payment of interests or dividends can be subject to withholding tax.
- ❖ With the Growth Opportunities Act, a debt-capacity test was included in the Foreign Tax Act. This test is adopted from the OECD, but has been implemented more tightly. According to this test, it does not comply with the arm's length principle if an interest expense resulting from a cross-border financing relationship within a multinational group of companies has reduced the taxpayer's income and the taxpayer cannot credibly demonstrate that it could have provided the debt service for the entire term of this financing relationship from the beginning and that the financing is economically necessary and used for the business purpose.

If an energy project is carried out in Germany and investments are made in buildings, equipment and machinery, the depreciation amount is deducted from income, which reduces taxable income.



- ❖ Land is not depreciable property, and so its cost generally cannot be depreciated and thereby deducted against income.
- ❖ Mining companies, quarries and other operations that involve the consumption of substance can either make use of straight-line depreciation or they can make deductions in accordance with the consumption of assets. If an energy company extracts natural resources such as natural gas, oil or coal, which in turn are used to generate energy, this company has the option of calculating the deduction amount according to the ratio of the quantity extracted in the financial year to the total quantity available at the time of acquisition.

A special feature of the Trade Tax is the breakdown of the tax assessment amount to the municipalities with a permanent establishment (PE). Generally, the breakdown is based on the wages paid to the employees employed at the respective PE. However, often in practice there are no employees employed at the locations of the power generation plants (e.g. wind power plants). Therefore, special rules applying to wind and solar power plants were adopted in 2021 in order for the municipalities to be allocated a share of the tax assessment amount so they can levy Trade Tax.

Wind power plants in Germany with no employees of their own constitute PEs for German tax purposes acc. to Art. 12 of the German General Tax Code ("Abgabenordnung"):

- ❖ The OECD Report on the Attribution of Profits to Permanent Establishments considers PEs without personnel to be functionless, i.e. no profits can be assigned to a PE.
- ❖ However, Germany applies special rules ("BsGaV") for which a court case is existent that also assets without personnel functions in Germany would justify a certain taxable profit to be allocated to the PE.
- ❖ The difference in approaches of Germany (e.g. location of the PE) and other countries (e.g. the energy company's home countries) on the assets allocation could lead to double taxation in cross-border cases.

From a VAT perspective there are special tax rules with regard to energy companies as well, e.g.:

- ❖ Sales related to supply of electricity, gas or heating are subject to special VAT principles (e.g. with regard to the determination of the place of energy supply, reverse-charge-procedure, special rules for intra-Community supplies, intra-Community acquisitions and imports, etc.).
- ❖ Due to the continuously rising gas, electricity and oil prices, the German legislator attempted to provide relief for consumers and introduced a temporarily reduction of the VAT rate on gas and heat supplies from 1.10.2022 to 31.3.2024 from 19 % to 7 %.

## Other Tax Issues To Be Considered

- ❖ As of January 2023, end consumers are relieved of rising energy costs through energy price brakes under the Electricity Price Brake Act and Natural Gas Heat Price Brake Act ("Strompreisbremsegesetz" and "Erdgas-Wärme-Preisbremsegesetz").
- ❖ The energy price brakes are paid to energy suppliers, who pass them on to end consumers. This leads to an increased VAT risk arising for energy companies (e.g. due to the possibility of incorrect invoicing by the energy suppliers and an insufficient VAT credit by the end consumer).

In Germany, electricity tax must be taken into account, which is levied on electricity in the tax territory.

- ❖ The tax arises from the fact that electricity supplied by the supplier based in the tax territory is withdrawn from the supply grid by final consumers in the tax territory, or from the fact that the supplier withdraws electricity from the supply grid for its own consumption.
- ❖ Tax debtor is the supplier.

In addition, energy products are subject to energy tax in Germany. The term energy product includes, among others, brown coal, hard coal, petrol or natural gas.

- ❖ In relation to natural gas for example, the tax generally arises when natural gas supplied or self-produced in the tax territory (Federal Republic of Germany excluding Büsingen and the island of Helgoland) is withdrawn from the pipeline network for consumption.
- ❖ The tax debtor is the supplier if he is resident in the tax territory and the natural gas supplied is not withdrawn from the pipeline network by another supplier. Otherwise, the person who takes the natural gas from the pipeline network is the tax debtor.

The Growth Opportunities Act ("Wachstumschancengesetz") came into force on 27.3.2024 and claims to encompass measures aiming economic growth, investments and innovations. In total, the law has a relief volume of 3.2 bn. EUR. The following measures are / could be (directly or indirectly) related to the topics of energy and energy transition:

- ❖ Strengthening research and development tax incentives ("Forschungszulagengesetz");
- ❖ Improved tax depreciation rules;
- ❖ Extended loss carryforward rules;
- ❖ Tax incentives concerning the taxation of the private use of company e-vehicles;



- ❖ However, the enacted law does not include the initially intended climate protection investment premium which was supposed to be a tax incentive for investments in the decarbonization of the economy.

## Key investment issues for foreign investors

- ❖ Investments in renewable energies (e.g. wind farms, solar parks or storage sites): They should be made in a tax-optimised manner, especially with regard to the use of depreciation potential.
- ❖ Investments in the electricity grid: At the moment, the German electricity grid is not in a position to bear the high loads caused by the charging infrastructure for the 15 million e-cars by 2030. An expansion of the grid is therefore essential. This requires capital-intensive investments that can be financed in various ways. The different tax treatment of the financing options must be taken into account.
- ❖ Tax-optimized investments in energy projects by share or asset deals: Companies wishing to realise an energy project in Germany, such as the construction of a wind farm, must choose between a share deal and an asset deal. These differ, among other things, in terms of their tax implications. It is therefore essential to decide in advance in which form the project is to be realised. In order to implement the project in the most tax-optimised way possible, tax aspects must also play a role in this decision. This applies to both, the acquisition of an existing project and the development of a new one.
- ❖ Investments in the hydrogen infrastructure: A pipeline network with a length of 1,500 kilometres is to be built by 2027/2028, which will generate investment potential. There is also the possibility of investing in hydrogen power plants and hydrogen storage facilities. As the use of hydrogen is subsidised, subsidies should be identified at an early stage.

## Relevant Experience

- ❖ Restructuring of energy suppliers and electricity grid operators
- ❖ Advise on M&A activities in wind park projects (investment & sale)
- ❖ Advise on transfer pricing systems for corporations in the energy sector including the trade of energy
- ❖ Advise on the determination of PE profits
- ❖ Ongoing advise during tax audits in the energy sector
- ❖ Application of APA and MAPs for companies in the energy sector.



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