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1. Types of Business Entities Commonly Used, Their Residence and Their Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

Businesses generally adopt the form of a limited liability company (GmbH) or a joint stock company (AG). These corporations are taxed as separate legal entities. The key differences between the two relate to the treatment each receives under commercial law.

Under a GmbH the shareholders are authorised to give instructions to a managing director, there is a low degree of fungibility of shares and there is a wide range of possibilities for the design of the articles of association.

Under an AG a supervisory board and a management board are mandatory, with both operating independently from the shareholders regarding the business decisions. There is personal liability for the management and supervisory board, and there is a high degree of fungibility of shares.

1.2 Transparent Entities

The type of partnership most commonly used for transparent entities is the *Kommanditgesellschaft* (KG). The KG is most commonly adopted for investment purposes due to its limitation of liability. Only one shareholder (*Komplementär*) is unlimitedly liable as the General Partner (GP), while the liability of the other shareholders (*Kommanditist*) is limited to their compulsory contribution. It is also possible to choose a GmbH as the GP; this means that no individual is subject to unlimited liability. This kind of partnership is referred to as GmbH & Co. KG and is usually chosen for private equity structures.

1.3 Determining Residence

According to German tax law, the residence of incorporated businesses depends on the question of where the following are situated: (i) the place of management; and (ii) the statutory/registered seat. Usually, the double taxation treaties provide regulations that the place of effective management is decisive in the case of a double residence of a corporation (the "tie-breaker rule").

1.4 Tax Rates

Corporations with a registered seat or place of management based in Germany are subject to unlimited tax liability in Germany. Non-resident corporations are only taxed on their German-sourced income. The income of a corporation is qualified as business income that is subject to corporate tax and municipal trade tax at an approximate total rate of 30%.

The corporate tax rate (including a solidarity surcharge) stands at 15.825%. A special tax rate applies for shares held in other corporations. Dividends received (as of 1 March 2013, only where the shareholding exceeds 10%) and capital gains recognised from the disposal of shares are tax-exempt, although 5% of the proceeds are deemed non-deductible expenses, resulting in an effective corporate tax burden of approximately 0.7%.

Municipal trade tax rates range from 13% to 17%, depending upon the municipality the business operates in. For trade tax purposes, capital gains from the sale of shares are generally tax-exempt, whereas dividends received from a German-located corporation are only tax-exempt if the shareholding amounts to at least 15% (or 10% if the shareholding is received from an EU company). However, 5% of the proceeds are deemed non-deductible expenses, resulting in an effective trade tax burden of approximately 0.7%.

However, it is being discussed that the tax exemption for capital gains for corporate income tax, as well as trade tax purposes, will only apply for shareholdings of at least 10% in future.

Partnerships such as a KG are transparent for income/corporate tax purposes so that profits and losses are taxed at the partners' level. Assets, liabilities and income of the partnership are generally allocated to the partners in proportion to their partnership interests. Municipal trade tax, however, is levied at the level of the partnership (if it conducts a trade or commercial activity).

The taxation of the income of individuals (who own a business or are a partner in a transparent partnership carrying out a business), generated either by themselves or through the partnership, generally depends upon their personal tax rate; tax rates are up to 47.5%, including a solidarity surcharge of 5.5%, and also possibly a church tax. However, dividend payments, as well as capital gains from the sale of shares which are realised in the context of a business, are subject to so-called "partial-income procedures", so that only 60% of the income deriving from dividends or capital gains will be taxed.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

As corporations are legally obliged to keep records, they have to determine their income through the comparison of business assets and annual financial statements. Generally, tax accounts depend on the financial accounts according to the principle of "decisiveness" ("*Maßgeblichkeitsgrundsatz*"). However, there are some deviations of tax accounts from financial accounts, such as the restriction of the application of current value tax depreciation to cases of permanent depreciation, the prohibition of provisions for onerous contracts, and the discounting requirement for long-term interest-free liabilities, with interest at below the market rate.

Where taxpayers are obliged to balance (eg, corporations), profits are taxed on an accrual basis (the "realisation principle").

2.2 Special Incentives for Technology Investments

As yet, there is no specific, comprehensive support for R&D by way of special tax treatment in Germany. However, on 27 June 2019 the German Parliament passed a draft law to support R&D with tax benefits ("*Forschungszulagengesetz*"). The Federal Government intends to use this to encourage primarily small and medium-sized enterprises to invest more in their own research and development activities. Essentially, all companies are entitled to subsidies, but projects shall benefit only if they fall into the categories of basic research, applied research or experimental development within the meaning of this Act. The subsidy consists primarily of a proportionate reimbursement of the wage costs for the employees of the respective beneficiary. The maximum grant is EUR500,000.

2.3 Other Special Incentives

Germany provides special investment incentives to small and medium-sized companies by way of an additional capital allowance of up to 20% of the original costs and investment, and a deduction of up to 40% of the prospective original costs.

2.4 Basic Rules on Loss Relief

Regarding income and corporate tax, loss relief is granted through the application of the following instruments.

Firstly, the positive and negative income of one year is netted.

Secondly, taxpayers may choose to carry back the losses to the previous year, or they may choose to carry forward the losses indefinitely. In the case of carry-back, any losses may be offset against the profits of the preceding year up to EUR1 million. An offset by way of carry-forward is possible up to EUR1 million annually without restriction. Regarding negative income that exceeds the EUR1 million threshold, in each subsequent year only 60% of additional income can be offset against such losses carried forward. The transfer of a share percentage over 50% may result in a total forfeiture of carry-forward not yet offset. These rules exceptionally do not apply if there are hidden reserves taxable in Germany reaching the amount of the carry-forward not yet offset. Furthermore, these regulations do not apply in the case of intra-group acquisitions of shareholdings (ie, group relief). However, the requirements for this are very strict and hard to meet.

A case is currently pending before the Federal Constitutional Court in which it is to be clarified whether the 50% limit is unconstitutional or not. It is likely that this regulation is also declared unconstitutional. In the case of trade tax, trade earnings may be reduced by loss carry-forward; carry-back is not provided. An offset is possible without restriction against losses of up to EUR1 million; regarding losses exceeding EUR1 million annually, only 60% of losses may be offset against subsequent trade earnings. The rules regarding forfeiture of carry-forward are the same as for corporate tax.

However, there is another possibility to prevent the forfeiture of the loss carry-forward not yet offset if more than 50% of the shares are transferred. This requires that strict conditions are met cumulatively (eg, time-limited application in the tax declaration, continuation of the same business). Furthermore, no so-called "harmful event" must have taken place (eg, discontinuance of the business, an additional business area is added). When these strict conditions are met, the loss carry-forward not yet offset is determined separately as so-called "accumulated loss carried forward" ("*fortführungsgebundener Verlustvortag*") and can be offset against the profits. This accumulated loss carried forward is determined annually. As soon as one of the strict conditions is no longer met, the accumulated loss carry-forward is fully lost unless it is covered by hidden reserves subject to domestic tax.

2.5 Imposed Limits on Deduction of Interest

German tax law provides interest barrier regulations. Interest expenses may be deducted without restriction up to the amount of interest income obtained in the same business year; amounts in excess are only deductible up to the amount of 30% of EBITDA. This restriction does not apply if interest income does not exceed EUR3 million each business year, or if the company is only partially part of a group of companies ("standalone clause"), or if an equity comparison shows an equity equal to or higher than the equity of the group of companies ("escape clause").

The standalone clause does not apply to corporations in the case of harmful debt financing (interest payable to the shareholder exceeding 10% of such interest payable that exceeds interest income) by shareholders/persons related to shareholders/third parties with considerable influence on shareholders holding more than 25% of shares in the corporation. The escape clause is not applicable in the case of harmful debt financing within the whole group of companies. Interest exceeding the 30% threshold may be carried forward indefinitely, except in the case of the sale of more than 50% of the shares within five years.

2.6 Basic Rules on Consolidated Tax Grouping

Consolidated tax grouping ("*Organschaft*") enables groups of companies to offset the losses and profits within a group of subsidiaries against the profits of their parent company (and profits transferred to the parent company from other subsidiaries). It requires that:

- the parent company holds the majority of voting rights in the subsidiary;
- the parent company has unlimited tax liability in Germany; and
- a profit transfer agreement has been concluded and executed for at least five years prior.

However, it should be noted that the parent company is also liable for the losses of its subsidiaries.

2.7 Capital Gains Taxation

Effectively, 95% of capital gains deriving from the sale of shares in other corporations are tax-exempt, resulting in an effective tax rate of 1.5%. However, from time to time it is discussed that the tax exemption for capital gains will only apply for shareholdings of at least 10% in future.

2.8 Other Taxes Payable by an Incorporated Business

If immovable property is transferred, real estate transfer tax (RETT) becomes due. The applicable tax rate depends on the question of where the immovable property is situated in Germany and varies between 3.5% and 6.5%. If at least 95% of the shares in a corporation or, similarly, at least 95% of the partnership interest in a partnership owning real estate situated in Germany is directly or indirectly transferred to one purchaser or a group of related parties then the transaction could trigger RETT. Furthermore, if at least 95% of the partnership interest in a partnership owning real estate situated in Germany is directly or indirectly transferred to new shareholders within five years, RETT could be triggered.

The Annual Tax Act 2019 provides (i) to lower the thresholds to 90%, (ii) to extend the period for partnerships from five to ten years and (iii) to apply that ten-year period to corporations as well. The Federal Government has suspended the implementation of these changes; originally 1 January 2020 was planned, but implementation is now expected at some point in the first half of 2020.

2.9 Incorporated Businesses and Notable Taxes

Incorporated businesses are generally subject to VAT; however, they are usually able to claim input VAT as well.

3. Division of Tax Base Between Corporations and Non-corporate Businesses

3.1 Closely Held Local Businesses

Closely held local businesses are mostly structured as limited liability companies (GmbH) or as limited partnerships with a limited company as general partner (GmbH & Co. KG).

3.2 Individual Rates and Corporate Rates

If an individual professional does not intend to retain the profits of the corporation, but instead pay out the profits, by way of either salary or dividends, then they face an overall tax burden of up to 50% – in the case of dividends this is split into two levels: corporate/trade tax at the level of the corporation as well as individual tax at a flat rate. Thus, there is no benefit.

3.3 Accumulating Earnings for Investment Purposes

There are no measures in place to prevent closely held corporations from accumulating earnings for investment purposes. The retained earnings of corporations are taxed at a lower rate than distributed profits.

3.4 Sales of Shares by Individuals in Closely Held Corporations

There are no special taxation rules for closely held corporations; the general rules apply (see below).

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

Where shares are part of the private assets of an individual, dividends are taxed with a flat tax rate of 25% with an additional 5.5% solidarity surcharge, resulting in a final valid tax rate of 26.375%. Capital gains on the sale of shares are also taxed at this flat tax rate if the individual's stake is below 1%.

The "partial-income procedure" (taxation of only 60% of proceeds at the progressive tax rate) is applicable if the stake equals or exceeds 1%, resulting in a maximum tax rate of approximately 30%. For the determination of income from capital gains, a lump sum of EUR801 is deducted generally.

If the stake is below 1%, regarding the offset of losses from capital gains, there are several restrictions – for example, only gains of the same kind of income may be offset. If the stake equals or exceeds 1%, there is no restriction regarding the offset of 60% of the losses from capital gains.

If the shares are part of the individual's business assets, the flat tax rate of 26.375% is replaced by the personal tax rate for both dividends and capital gains. However, only 60% of dividends for capital gains are taxed and only 60% of operating costs are deductible.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

The withholding tax is principally levied on dividends at a rate of 26.375% (including a solidarity surcharge). Non-EU corporations with limited tax liability may request a reimbursement of two-fifths (40%) of withheld tax so that the tax burden effectively amounts to 15.825% (including a solidarity surcharge) and is therefore equal to the tax burden for German corporations. The application of this regulation requires that the non-EU corporation is active within Germany. EU corporations which are subject to a limited tax liability benefit from the Parent-Subsidiary Directive. Under this directive they may obtain a 100% tax exemption for dividends, provided that the parent company has held a direct stake of at least 10% in the subsidiary for a continuous period of 12 months or more. Certain activity requirements need to be met. Furthermore, withholding tax might be reduced as well, according to treaties.

Under current German law, an EU corporation must prove sufficient substance in the form of an equipped business and that the income was generated by its own economic activities. However, it should be noted that these requirements were recently declared to be not compliant with EU law by the European Court of Justice (ECJ). Nevertheless, German tax authorities still apply such rule; new substance regulations are expected from the German legislature in due course.

Only specific interest is subject to withholding tax: this includes profit-related interest, interest collateralised by real estate in Germany and exceptions such as interest resulting from "over-the-counter transactions" and interest attributed to other types of income.

In all other cases, interest income is not subject to limited tax liability and is therefore not subject to withholding tax. Interest paid from an EU corporation to an EU corporation may be tax-exempt if the Interest and Royalties Directive is applicable.

Royalty payments are subject to limited tax liability and withholding tax at an amount of 15.825%, which is levied from the gross income.

4.2 Primary Tax Treaty Countries

Due to the favourable taxation measures granted to EU corporations, most foreign investors invest via EU member states. The most common tax treaty countries are the Netherlands and Luxembourg.

4.3 Use of Treaty Country Entities by Non-treaty Country Residents

German tax law has several anti-treaty-shopping clauses in order to prevent the abuse of tax treaties. German tax authorities therefore check whether an entity claiming for tax relief with reference to a tax treaty generates its income through its own activities and whether there are considerable reasons to act via the tax-privileged entity in question.

Furthermore, there are subject-to-tax clauses which prevent certain income from being taxed in neither of two treaty countries.

4.4 Transfer Pricing Issues

The main issue in tax audits regarding transfer pricing is ensuring compliance with the arm's-length principle. Other issues are the examination of the transfer pricing methodologies chosen, the assessment of the attribution of beneficial ownership in the companies' assets as declared, and ensuring the fulfilment of formal requirements when issuing the obligatory reports.

4.5 Related-Party Limited Risk Distribution Arrangements

All transactions within a group of companies must meet the requirements of the arm's-length principle.

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

Germany makes explicit reference to OECD standards in the circulars issued by the Federal Ministry of Justice and case law; furthermore, legal provisions, such as Section 1 of the Foreign Tax Act, are based on the OECD standards.

5. Key Features of Taxation of Non-local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims are Settled

Generally, German tax authorities scrutinise compensating adjustments critically and recognise them only subject to strict conditions. Consequently, compensating adjustments must be based on a previously agreed pricing method that is applied in pre-defined scenarios of uncertainty and leads to an "arm's-length" result. The underlying Principles of Administrative Procedure have not been updated since 2005 and, despite international developments (eg, by the EU Joint Transfer Pricing Forum), an update is not expected in the near future. There are no reports on any particular difficulties in operating MAPs.

On the contrary, based on recent MAP statistics of December 2017, only 1% of completed procedures involving Germany could not be settled. Hence, the overall operation of MAPs is deemed satisfactory.

5.2 Taxing Differences

Generally, there are no differences between local branches of non-local corporations and local subsidiaries of non-local corporations; however, in practice, there are usually problems, or at least discussions, regarding the allocation of income/expenses and assets.

5.3 Capital Gains of Non-residents

Capital gains of non-residents on a sale of stock in local corporations are taxed if the shareholding is at least 1%. However, the tax treaties usually eliminate such taxation.

5.4 Change of Control Provisions

A change of control might result in the (partial) forfeiture of tax losses carried forward in the case of a change of at least 25% of the shareholding (see **2.4 Basic Rules on Loss Relief**).

Furthermore, the real estate transfer tax (RETT) could be triggered by certain transactions with corporations/partnerships owning real estate (see **2.8 Other Taxes Payable by an Incorporated Business**).

5.5 Formulas Used to Determine Income of Foreign-owned Local Affiliates

There are no specific formulas used to determine the income of foreign-owned local affiliates selling goods or providing services, but it must be ensured that the determination follows the arm's-length principle.

5.6 Deductions for Payments by Local Affiliates

There are no specific rules regarding the deduction for payments by local affiliates for management and administrative expenses incurred by a non-local affiliate. However, in general, the arm's-length principle and the transfer pricing rules must be taken into consideration.

5.7 Constraints on Related-Party Borrowing

Any borrowing between related parties must comply with the arm's-length principle. The granting by a local affiliate of an interest-free loan or of one with an interest below market standards may result in a hidden profit distribution. In comparison, a loan granted with an interest that is above market standards may result in a hidden contribution.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

In principle, the worldwide income of local corporations is taxed in Germany. The part of the income of a local corporation which originates from foreign sources which are taxed in the state of source with a tax comparable to German corporate tax is taxed in Germany, taking into account the tax paid abroad. If a double tax treaty applies, the regulations laid down there have priority. A 95% tax exemption applies for dividends and capital gains from foreign sources if the shareholding is at least 10% (for corporate income tax) and 15% (for trade tax).

For CFC taxation see **6.6 Rules Related to the Substance of Non-local Affiliates**.

6.2 Non-deductible Local Expenses

If foreign income is tax-exempt in Germany, corresponding expenses which are economically directly connected to such income are not deductible in Germany.

6.3 Taxation on Dividends from Foreign Subsidiaries

Under German tax law, for income to qualify as dividend income the same rules apply regardless of the origin of the dividends from foreign or local sources. Thus, under income tax aspects, 95% of dividend income is tax-exempt, except dividend income deriving from free-float below 10%.

For trade tax, the tax exemption for proceeds resulting from foreign subsidiaries is granted if the local corporation holds at least 15% of the subsidiary. Under certain provisions (especially activity) even a sub-subsidiary may benefit from this privilege.

6.4 Use of Intangibles

Intangibles may be transferred or let (royalties) at arm's-length conditions resulting in taxable income (transfer price or royalties) at regular rates.

6.5 Taxation of Income of Non-local Subsidiaries Under CFC-Type Rules

Generally, passive low-taxed income of non-local subsidiaries (dominated by Germans) is taxed in Germany.

The income is added to that of the local corporation and is then subject to regular German tax rules. In the case of passive investment income, the income will be taxed in Germany even in cases where German shareholding is 1% or below.

6.6 Rules Related to the Substance of Non-local Affiliates
German CFC rules do not generally relate to the substance of non-local affiliates. However, the carve-out from CFC rules which is provided for EU corporations requires – besides other conditions – that the non-local affiliate carries out an actual economic activity.

6.7 Taxation on Gain on the Sale of Shares in Non-local Affiliates
The gains made by local corporations on the sale of shares in non-local affiliates enjoy the same 95% tax exemption as granted for the sale of shares in local subsidiaries. However, for trade tax purposes this requires that the non-local affiliate carries out only or almost only an active activity. Furthermore, it is still under discussion whether to apply the tax exemption for capital gains only for shareholdings of at least 10% in future. To date, no concrete steps have been planned.

7. Anti-avoidance

7.1 Overarching Anti-avoidance Provisions
Section 42 of the General Tax Code provides for a general anti-avoidance rule which applies in case of abusive tax structures. On the level of the EU, the Anti-Tax Avoidance Directive (ATAD) establishes a common minimum level of anti-avoidance rules that every member state has to ensure compliance with.

8. Other

8.1 Regular Routine Audit Cycle
There is no audit cycle prescribed by law. However, audits generally tend to take place once every three to four years.

9. BEPS

9.1 Recommended Changes
At year-end 2016, the BEPS 1 Implementation Act passed the German legislation process. This was the first step to implement the recommendation of the BEPS process into domestic law.

The BEPS 1 Implementation Act leads to an extension of co-operation obligations in cross-border situations which is based on BEPS action point 13 – Transfer Pricing Documentation and Country-by-Country Reporting. As a result, the transfer pricing documentation now consists of (i) a master file, (ii) a country-specific and company-related local file, and (iii) a country-specific country-by-country report. Furthermore, the information exchange standards and reporting obligations arising from the amendments to the EU Mutual Administrative Cooperation Directive have been implemented into German law. The amended transfer pricing documentation rules are applicable for the first time to fiscal years starting after 31 December 2016. The country-by-country report is to be prepared for fiscal years starting after 31 December 2015 and to be submitted to the German tax authorities by 31 December 2017.

As of 1 January 2017, tax rulings (ie, advance cross-border rulings and advance pricing arrangements) issued, reached, amended or renewed after 31 December 2014 must be automatically exchanged amongst the EU member states. These amendments take the recommendations made in BEPS action point 5 – Measures to Counter Harmful Tax Practices – into account.

Furthermore, Germany has introduced a provision to limit the tax deductibility of licence fees or royalty payments to foreign-related parties that benefit from preferential tax regimes (such as intellectual property, licence or patent boxes) which are incompatible with the OECD nexus approach of BEPS action point 5 – Measures to Counter Harmful Tax Practices.

Additionally, the BEPS 1 Implementation Act introduced a new regulation into domestic law in order to prevent double taxation of business expenses (ie, double deduction) for partnerships effective from 1 January 2017.

Germany also signed the OECD Multilateral Instrument in June 2017. As a first step, Germany would like to amend over 30 of its approximately 100 double tax treaties, provided that the other countries agree. At present, it remains unclear when the ratification of the MLI will be completed. No national draft legislation to implement the MLI has been published as of yet. Whether the implementation of the MLI can be undertaken within the current legislative period, as initially expected, remains to be seen.

In compliance with the recommendation of BEPS action point 12 and the EU Directive on Administrative Cooperation in the field of taxation, the government's draft legislation introducing disclosure obligations regarding cross-border tax arrangements was adopted in October 2019. In view of the EU requirements, particularly the obligation to implement the directive by 31 December 2019, no significant changes to the draft are to be expected in the further legislative process.

9.2 Government Attitudes
The broad implementation of the recommendations and standards of the BEPS project is explicitly mentioned in the 2018 coalition agreement of the German governmental parties. The German government has ever since fully supported the BEPS project and Germany played a prominent role in the project,

both politically and professionally. As Germany already has comparably strict tax laws, the intention of the German government with regard to BEPS is, in particular, to enforce stricter international taxation standards in the EU and other countries in order to achieve fair tax competition between countries. Due to his aspirations to become the new chairman of his party, the current Minister of Finance is under considerable pressure to succeed, which may accelerate legislative procedures and hence the implementation of the BEPS measures.

9.3 Profile of International Tax

There is public concern whether the current applicable international tax law is able to keep up with the challenges of globalisation or enables tax avoidance and allows base erosion and profit-shifting advantages. The discussion was sparked in 2012 by media reports of Starbucks avoiding taxes on a large scale in the UK and was then extended to global IT firms and swept over other EU countries.

Developments such as "the Luxembourg Leaks" and "the Panama Papers" particularly influenced public and political discussions on aggressive tax structures (such as intellectual property boxes) and underlying tax rulings, which lead to tax rates of less than 5%. As a result, not only the German business and political press but also the tabloids frequently reported about such developments. However, neither the BEPS project nor the implementation of its recommendations receives significant media attention.

9.4 Competitive Tax Policy Objective

As a strong export country, Germany does not pursue a competitive tax policy objective. In fact, Germany has already introduced anti-abuse and CFC rules in order to limit base erosion and profit-shifting. As a result, Germany seeks to achieve international standards for fair and realistic tax competition.

9.5 Features of the Competitive Tax System

Germany does not have a competitive tax system that might be particularly affected by anti-BEPS measures.

9.6 Proposals for Dealing with Hybrid Instruments

Hybrid instruments have mainly been used in Germany for cross-border financing. Meanwhile, Germany has implemented a domestic anti-abuse rule (the "correspondence principle") for interest income and dividend payments from hybrid instruments of foreign corporations that is applicable as of the 2014 assessment year. Furthermore, the very same correspondence principle has been considered in the EU Parent-Subsidiary Directive.

In line with the BEPS 1 Implementation Act, a separate regulation to prevent double deduction of business expenses for partnerships has been introduced into Germany domestic law, effective from 1 January 2017. The recommendations of BEPS action point 2 have been largely incorporated into the EU Anti-Tax Avoidance Directive 2 (ATAD 2). In December 2019, the German Federal Ministry of Finance unexpectedly submitted a draft legislation on the deduction of operating expenses with regard to hybrid structures in line with the provisions of ATAD 2. However, the current draft legislation has not been passed by the German government, let alone passed through parliament.

9.7 Territorial Tax Regime

The German tax regime is not territorial but residence-based. Germany generally taxes worldwide income, subject to tax treaties that usually exempt interest income of foreign shareholders from taxation. Originally, this was the reason for introducing thin-capitalisation rules. However, the interest-deduction limitation rules far exceed this scope and cover national structures as well.

According to these regulations, interest payable may be immediately deducted up to the amount of interest income obtained in the same business year; amounts in excess are only deductible up to the 30% of EBITDA. This restriction does not apply if interest income does not exceed EUR3 million each business year, or if the company is not part of a group of companies (the "standalone clause"), or if an equity comparison shows an equity equal to or higher than the equity of the group of companies (the "escape clause"). The standalone clause does not apply to corporations in the case of harmful debt financing (interest payable to the shareholders exceeding 10% of such interest payable that exceeds interest income) by shareholders/persons related to shareholders/third parties with considerable influence on shareholders holding more than 25% of shares in the corporation. The escape clause is not applicable in the case of harmful debt financing within the whole group of companies. Interest exceeding the 30% threshold may be carried forward indefinitely, except in the case of the sale of more than 50% of the shares within five years (see **2.5 Imposed Limits on Deduction of Interest**).

9.8 CFC Proposals

With respect to EU law, conflicts may be looming with the general drift of the CFC proposals, particularly with regard to the freedom of establishment. The ECJ has decided in the case of Cadbury Schweppes that CFC rules unjustifiably restrict the freedom of establishment, unless the specific objective of a CFC rule is to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out in national territory. Thus, the case law of the ECJ has limited the application of CFC rules. It is questionable whether the BEPS proposals consider this fact. Apart from that, German tax law already provides for strict CFC rules for offshore subsidiaries whose passive income is taxed at a "low rate" of less than 25%. However, it is possible that BEPS might result in selective changes of this regime.

9.9 Anti-avoidance Rules

To address the inappropriate granting of treaty benefits and other potential treaty abuse scenarios, Germany implemented domestic "anti-treaty shopping rules" several years ago. According to these regulations, benefits will not be granted if a company's main purpose is to gain access to advantageous conditions derived from DTC and/or EU directives (eg, the EU Parent-Subsidiary Directive). Furthermore, domestic subject-to-tax clauses to prevent under-taxation and non-taxation due to DTC or EU directive benefits and CFC rules are in place. Thus, German tax law already provides adequate regulations to address the abuse of benefits and tax avoidance in general.

9.10 Transfer Pricing Changes

Transfer pricing matters for intellectual property are a crucial issue for companies and advisors in Germany, as the evaluation, benchmarking and documentation of intellectual property are always challenged in German tax audits.

As a result of the recently introduced new transfer pricing documentation concept with the newly implemented country-by-country reporting, as well as the master file and the local file, intellectual property must be documented more extensively. Therefore, comments must be made regarding the creation, beneficial ownership, chances and risks, etc, of intellectual property. The new concept does not radically change things; however, intellectual property will be more transparent for tax authorities in Germany and other countries. Consequently, there are certain concerns that this could lead to more challenging tax field audit procedures, including income corrections in Germany and other countries.

9.11 Transparency and Country-by-country Reporting

Due to German transfer pricing reporting and documentation requirements, a certain transparency with regard to intercompany cross-border transactions already existed prior to the BEPS-project. Furthermore, there are disclosure obligations in case a German tax resident (an individual or a legal entity) establishes permanent enterprises or partnerships abroad or acquires shares in foreign corporations. In connection with the country-by-country reporting that has been implemented by the BEPS 1 Implementation Act, concerns must be raised, as companies will face further significant administrative barriers in the future. Finally, increased bureaucracy is to be expected due to the new disclosure obligations for cross-border tax arrangements based on BEPS action point 12 (see **9.1 Recommended Changes**).

9.12 Taxation of Digital Economy Businesses

Prompted by BEPS action point 1, the EU Commission adopted two legislative proposals in March 2018 relating to the taxation of digital activities in the EU. One of the two draft directives seeks to reform corporate tax rules so that profits are registered and taxed where businesses have significant interaction with users through digital channels. The 2018 coalition agreement of the current German governmental parties is generally supportive of an adequate taxation of the digital economy. However, the EU draft directive relating to the taxation of digital economy businesses has not been adopted yet and no German draft legislation has yet been published to this effect.

9.13 Digital Taxation

The second legislative proposal relating to the taxation of digital activities that was adopted by the EU Commission in March 2018 (see **9.12 Taxation of Digital Economy Businesses**) sought to impose an interim digital tax but was rejected at the EU finance ministers' meeting in March 2019. As one of the opposing EU members, Germany had rejected the proposed European digital tax in order not to pre-empt an international solution at G20 level in 2020. Should the efforts at an international level fail, Germany is considering a European or even national solution.

9.14 Taxation of Offshore IP

As of January 2018, Germany has restricted the tax deductibility of licence fees or royalty payments to foreign-related parties that benefit from preferential tax regimes (ie, licence or patent boxes) in order to discourage harmful tax practices relating to offshore intellectual property. This restriction, however, does not apply if a preferential tax regime is compliant with the nexus-approach of BEPS action point 5 and hence requires a sufficient degree of substance and research activity on the part of the licensor.

9.15 Other General Comments

Since the German legislature has already codified many regulations to prevent profit-shifting and to stabilise the German tax revenue during the last few years, the introduction of further substantial domestic anti-avoidance rules due to the BEPS process is not expected; however, amendments of the currently applicable rules are being discussed, such as an adjusted interest barrier rule and the definition of and allocation of profits to permanent establishments.

P+P Pöllath + Partners is an internationally operating firm, with more than 140 lawyers and tax advisers providing high-end advice in Berlin, Frankfurt and Munich. More than half of its professionals specialise in the tax implications of the firm's primary areas of expertise: transactions, asset management and private equity. It is particularly renowned for its close combination of tax and legal advice regarding all the main practice areas of P+P, such as M&A, private equity, real estate transactions and family businesses. Corporate tax services include the structuring of national and international M&A and subsequent reorganisations, corporate tax planning and the structuring of national and international groups of companies, and the application and interpretation of double taxation treaties.

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