European Parliament, Subcommittee on Tax Matters (FISC)

Public hearing on "Case studies on Member States national tax policies – Germany: implemented national tax reforms and the combat against aggressive tax schemes"

Tuesday, 28 March 2023, 16.00 to 17.30

Introductory Statement by Bettina Rodenberg, CVP Global Tax & Trade Group, Henkel

- Dear Mr Chairman, dear Vice Chairs, honourable members of the European Parliament, thank you for inviting me to take part in today's hearing on "Case studies on Member States national tax policies – Germany: implemented national tax reforms and the combat against aggressive tax schemes".

- The increased agility of companies and growing scalability of business models as well as the ever-evolving digitalization fostered global tax competition between states. To combat and prevent tax avoidance, the activities of legislators have intensified massively.

- Since the mid-1990s one could observe veritable efforts against international tax planning. Just to name the most recent international projects: OECD BEPS Pillar 1 (referred to as Pillar 1) aiming at a partial re-allocation of taxing rights and OECD BEPS Pillar 2 (referred to as Pillar 2) aiming at introducing a global minimum taxation. Also at EU level, several initiatives to fight tax avoidance were presented such as DAC6 and DAC7. Also, Germany has a long-standing tradition in introducing various legislative anti-abuse measures, even pioneering with the anti-abuse rule of section 42 of the German Tax Code.

- There are numerous additional, targeted anti-abuse provisions for cross-border activities of companies which have been introduced in the previous years. Many of these regulations that affect businesses originate in EU legislation or stem from international conventions and agreements. When it comes to national implementation, businesses in Germany often see themselves confronted with national requirements being extended compared to the measures stipulated in European directives and / or international agreements. The most recent example is the draft bill released last week to transpose the EU directive on ensuring a global minimum level of taxation for MNEs (Pillar 2) containing not less than 89 paragraphs.

- Today, I would like to give you an overview of the measures implemented in Germany so far and to lay down why they in many cases constitute complex and redundant provisions which are not necessarily needed against the background of the recently agreed Pillar 2 directive.

1. German Foreign Tax Code (since 1972)

- The most prominent measure to prevent shifting profits between jurisdictions is the German Foreign Tax Code (AStG) which was enacted in 1972 and which contains the following mechanisms:

  Provisions related to the cross-border relocation of functions

  - In Germany, the expansion or relocation of corporate functions together with their associated assets abroad triggers a final taxation. Even though it is intended to make the withdrawal of domestic company capital abroad less attractive for tax purposes, it means on the other hand that Germany becomes massively unattractive for local and foreign investments.

  German controlled foreign corporation rules (CFC rules)

  - German CFC rules aim at preventing the abusive interposition of subsidiaries in low-tax countries and to establish a minimum tax burden of 25%. The newly introduced Pillar 2 regulation captures the same objective but with a minimum tax burden of 15%, and Germany agreed to this approach. Therefore, German CFC rules are by no means longer required, especially considering German specific minimum tax burden of 25%.

  Individual exit taxation

  - Exit taxation is an instrument that imposes a final tax on the exit of individuals with shares in corporations. It is therefore particularly suitable for restricting freedom of movement and has therefore already been referred to the ECJ on several occasions.

2. Business Tax Regulations

- Additional business tax regulations such as the Corporate Income Tax Act (KStG), Income Tax Act (EStG), Reorganization Tax Act (UmwStG) also lead to numerous restrictions such as:

  Residence relocation (§ 12 KStG), German Exit Taxation in Mergers and Acquisitions

  - In accordance with the exit taxation of individuals, companies are also subject to taxation when they relocate their registered office. In addition, tax-neutral conversions are only possible if the target structure subsequently remains in Germany for a certain period of time.

  - These instruments also massively restrict the free movement of companies and can therefore not only act as a barrier to exit, but also as a barrier for foreign companies to invest in Germany.

German interest barrier rule („Zinsschranke", since 2008, § 4h EStG and § 8a KStG)

- The interest barrier restricts the deductibility of interest expenses. This means that expenses actually incurred at the company's level can no longer be deducted completely. This restriction violates the objective net principle, which arises from the German Basic Law (Art. 3 GG) and is therefore also subject to review by the German Federal Constitutional Court.

- Due to the doubtfulness of the constitutionality of the currently applicable interest barrier, we cannot comprehend why the deliberations on the European Commission's proposal for a Debt-Equity Bias Reduction Allowance (DEBRA) aimed at a tightening of the interest deduction.

German royalty deduction limitation rule ("Lizenzschranke", since 2018, § 4j EStG)

- Expenses for the time-limited transfer of rights of use are only tax-deductible if the creditor of the rights of use is not subject to a low-taxed preferential regime. With this, profit shifting by means of licenses is completely prevented.

Provisions on preventing the abuse of treaty benefits (§ 50d EStG)

- Contrary to the OECD Model Convention and existing double taxation agreements, Germany has introduced so-called "treaty overrides" where legislation overrules the provisions of existing tax treaties. For example, the exemption of dividends in Germany is only applicable if it is ensured that the beneficial owner is subject to adequate taxation. This friction jeopardises the uniformity of the rules and unilaterally increases the audit and documentation burden, thereby undermining the idea of harmonisation.

3. *Use of internal tax control systems*

- The German legislator has created a regulation, initially for a limited period, to use companies' internal tax control systems to modernize tax audits. In general, the introduction of this regulation in order to achieve cooperative and process-oriented tax audits is appreciated. In case businesses have a tax compliance management system in place, tax authorities should focus on the underlying tax controls instead of single documents. In this way, low-risk tax issues can be identified, for which the need for an audit is not pronounced. In this context, a permanent framework outlining the design of an internal tax control system may also be useful.

- Let me conclude by recalling that in the context of the global "level playing field" for the taxation of corporate profits under Pillar 2, a comprehensive reform of corporate taxation in Germany is necessary:

    - First, this implies at least a lowering of the low taxation threshold for the Controlled Foreign Company rules to 15 percent.

    - Second, the existing anti-abuse regulations, which I have partly described above, should be abolished at least for businesses which fall under the scope of Pillar 2 and in any case be improved. This does not only apply to the German Controlled Foreign Company rules, but also to the royalty and interest barrier and additional anti-abuse regulations.

- Overall, the EU and Germany must boost its competitiveness and should draw inspiration from the Inflation Reduction Act (IRA) of the Biden administration. Furthermore, the over boarding administrative burden of Pillar 2 leads to high costs and massive risks for MNEs and should be revisited. Taking the above said into account, a non-bureaucratic, consistent and forward-looking approach is needed to make the legal landscape better and more effective. Otherwise, the EU risks jeopardizing the competitiveness and appeal of Europe and Germany as an industrial business location.