Economic stimulus package 2020 – all tax proposals at a glance

IN ORDER TO FIGHT THE ECONOMIC CONSEQUENCES OF THE COVID-19 PANDEMIC, THE FEDERAL GOVERNMENT HAS DECIDED TO LAUNCH AN ECONOMIC STIMULUS AND CRISIS MANAGEMENT PACKAGE.

Executive Summary

- On 3 June 2020, the German federal government adopted a comprehensive economic stimulus and crisis management package.
- The adopted package also includes a large number of tax measures designed to stimulate the economy.
- Highlights are the temporary VAT rate reduction, the extended tax loss carry-back and the introduction of an option for partnerships to be taxed like corporations.

Economic stimulus and crisis management package

On 3 June 2020, the German federal government adopted the comprehensive economic stimulus and crisis management package "Fighting COVID-19 effects, securing prosperity, strengthening sustainability". This GSK Update presents the various tax measures this package contains. However, no draft bill has yet been presented. It is therefore not yet clear what the measures will look like in detail.

Reduced VAT rates

In order to stimulate domestic demand in Germany, the regular VAT rate will be temporarily reduced from 19% to 16% and the preferential VAT rate will be reduced from 7% to 5% from 1 July 2020 to 31 December 2020.

Even though this reduced VAT rate incentive for the domestic economy is to be welcomed, its implementation does also require a substantial short-term effort of the companies concerned, causing additional costs (e.g., regarding IT systems, cash register systems, internal processes and the examination of tax-related effects) and requiring personnel. Additionally, the changes made will then need to be reversed at the end of the year causing new costs and requiring personnel.

While there is practical experience from dealing with past VAT rate increases, a VAT rate reduction is a real novelty. It remains to be seen whether the legislator will base the announced reduction on the known mechanisms of past increases in VAT rates.

Tax loss carry-back

For tax purposes, losses are generally primarily offset in the same year when determining that year's total revenue. Losses are first[1] compensated with income of the same type of income (i.e., losses from one commercial activity against income of another commercial activity) without restrictions. Remaining losses can then generally[2] be offset without restriction against positive income from other types of income (i.e., losses from commercial activity are compensated with income from letting or leasing).

If losses still remain, an amount of EUR 1,000,000 (EUR 2,000,000 for married couples if assessed jointly for tax purposes) can currently be deducted from the total amount of income of the immediately preceding

[1]Subject to potential offsetting prohibitions.
[2]Subject to potential offsetting prohibitions.

assessment period (if the assessment period is the calendar year, essentially the previous year). This is called a loss carry-back. Alternatively, the loss can also be carried forward to the next year. However, the amount of losses that can be carried forward to future assessment periods is limited by the regulations on minimum taxation.

As part of the economic stimulus package, the amounts for tax loss carry-back are being increased for 2020 and 2021 from EUR 1,000,000 (or EUR 2,000,000) to a maximum of EUR 5,000,000 (or EUR 10,000,000 in the case of jointly assessed couples). This is going to be supplemented by a mechanism that allows this carry-back to already take financial effect in the tax return for 2019, e.g., through the creation of a tax “corona reserve”.This reserve would then be released by the end of 2022 at the latest.

Because of the increase in the maximum possible tax loss carry-back, the expected (high) losses for the years 2020/2021 could be recovered much more quickly and to a much greater extent than is currently the case. Companies may also welcome the complementary liquidity assistance which allows for a corresponding reserve to be included as soon as in the 2019 tax return. As a result, companies would not have to pay the full tax for 2019 right away but only retroactively following the loss carry-back to be declared for 2020 or 2021.

Degressive depreciation

If no increased deduction or special depreciation is currently applicable, the linear depreciation method to be used for tax purposes, meaning the depreciation is distributed in equal annual amounts as per the usually expected life cycle.

The degressive depreciation method, which measures depreciation in falling annual amounts according to a fixed percentage rate of the respective book value, has been abolished for many years.

As a tax investment incentive, the stimulus package now envisages reintroducing this method for moveable assets for the fiscal years 2020 and 2021 with a factor of 2.5 compared to the currently applicable linear depreciation rate. The maximum amount of the depreciation rate is limited to 25%.

The degressive depreciation for movable assets is used at irregular intervals to promote economic activity. It was last available for purchases or production between 1 January 2009 and 31 December 2010. At that time a factor of 2.5 applied as well compared with the currently applicable depreciation rate and a maximum of 25% per year. Practical experience gained in the past can, therefore, be used for this measure.

Introducing of an option model

A special feature of the taxation of partnerships is that partnerships are considered transparent for tax purposes (with the exception of trade tax). Partnership profits are, thus, allocated directly to the partners and taxed according to their personal tax rate (i.e., up to 45% plus solidarity surcharge in the case of natural persons). This applies even if, as is often the case in a crisis, partners do not withdraw their profit in order not to jeopardise the partnership’s liquidity. Although the German Income Tax Act provides for the possibility to retain profits, this is only very rarely applied, as it is relatively unattractive from a tax point of view.

Presumably against this background, the partners of partnerships are now to be granted the right to have their partnership taxed like a corporation. If they make use of this option, corporate income tax (15.825% incl. solidarity surcharge) would be applied on the level of the partnership. On the level of the partners, in return, a further tax burden would only arise once they withdraw profits.

However, the specific features of this option model are not yet clear. The question of how the profits withdrawn by the partners will be taxed (final withholding tax or personal tax rate?) is of particular importance, as well as whether the option leads to a change of the company’s legal form with which consequences or how special business assets and profits / losses will be treated.

Due to the great complexity of this option model, it seems very ambitious to introduce it fast enough to respond to the current crisis.

Crediting trade tax

Trade tax may not be deducted as a business expense for income tax purposes. Sole proprietors as well as partners of a partnership that is subject to trade tax, therefore, face a double burden of income and trade tax.

In order to mitigate this, the stimulus package will grant an income tax reduction to sole proprietors and partners that are natural persons (thus in particular not to partners that are corporations). This is done by (partially) crediting trade tax against income tax. The amount of such credit is limited to the trade tax amount actually paid and to 3.8 times the (possibly proportional) trade tax base amount (maximum reduction). The trade tax base rate is calculated by applying the statutory basic tax rate of 3.5% to the income from the trade business.

The maximum reduction is now going to be limited to 4 times the trade tax base amount. This is obviously intended to account for the fact that the municipalities' trade assessment rate is often higher than 380% and thus more than 3.8 times the trade tax base amount.

This increase in the maximum amount of the credit is generally a positive development. However, taxpayers in municipalities with a trade tax assessment rate of more than 400% will still face a double tax burden even after the planned changes. From a legal policy point of view, it would, therefore, be preferable to abolish the prohibition of deducting trade tax as an operating expense. This would also benefit corporations.

Increase in tax-free allowance for add-back items

When determining the trade tax base, certain business expenses (including interest, rent and royalties) are added back to the taxable profit in varying amounts if their total amount exceeds the tax-free amount of EUR 100,000.

The economic stimulus package now includes plans to increase this tax allowance to EUR 200,000.

Import VAT due dates

According to the German VAT Act, import VAT is levied on the import of goods into Germany from country outside of the EU. In principle, import VAT is payable within the period set by the customs authorities, which in principle may not exceed ten days from the date of notification of the customs debt to the debtor (in principle the declarant, i.e. generally the person filing a customs declaration in his own name or on whose behalf a customs declaration is made).

The German VAT Act generally grants a deduction of input tax from import VAT incurred, although this deduction can usually only be made at a later date in the context of the advanced VAT return, entailing a liquidity disadvantage for the taxpayer.

The economic stimulus package provides for the due date of the import VAT to be postponed to the 26th of the following month, counteracting the liquidity disadvantage just described. Since no time frame has been indicated for the validity of this measure, it seems that this change may be permanent.

Promoting employee participations

As part of the economic stimulus package the opportunities for employees to acquire participations in their company are to be improved. In particular, attractive opportunities for employee participation are to be created for start-up companies.

The details of how this idea is to be implemented are currently still unclear. One can assume that this will be done in particular by means of tax incentives, e.g. by increasing the tax-free allowance of currently EUR 360 for the provision of employee equity participations (cf. Sec. 3(39) Income Tax Act (EStG)).

Tax research allowance

According to the Research Allowance Act, taxpayers may, if they carry out eligible research, apply for a research allowance of 25% of the eligible expenses, which is received by offsetting it against income or corporation tax owed.

As part of the economic stimulus package, the tax research allowance is now to be granted retroactively from 1 January 2020 until 31 December 2025 on an assessment basis of up to EUR 4 million per company.

Adjustment of the vehicle tax

The vehicle tax, whose rate is currently based on the individual CO2 emissions and engine capacity, will be determined (even) more by the factor of the CO2 emissions. This is expected to noticeably promote lower-emission or zero-emission vehicles.

Furthermore, the ten-year vehicle tax exemption for purely electric vehicles is granted until 31 December 2025 and extended to 31 December 2030.

Increased tax relief for single parents

Due to the heavy burden in the context of child care in times of coronavirus pandemic and the expenses this caused especially for single parents, the relief amount for single parents will be increased for two years from currently EUR 1,908 to EUR 4,000 for 2020 and 2021, and thus more than doubled.

Conclusion

It is good news that the German federal government has decided to mitigate the effects of the coronavirus pandemic by means of economic stimulus measures. However, the rather selective measures are probably still not going to be received as a "masterstroke". Also, the associated costs for implementation and administration, especially regarding the temporary VAT rate reduction, should not be underestimated. Nevertheless, the measures will probably at least contribute to overcoming this crisis.

Please do not hesitate to contact us if you have any questions about the economic stimulus package's tax effects for your company.

Petra Eckl
Lawyer, tax consultant
Specialised lawyer for tax law
Frankfurt
petra.eckl@gsk.de

Dirk Koch
Lawyer, tax consultant
Specialised lawyer for tax law
Munich
dirk.koch@gsk.de

Dominik Berka
Lawyer, tax consultant
Frankfurt
dominik.berka@gsk.de

Andreas Ebert
Lawyer
Frankfurt
andreas.ebert.@gsk.de

Felix Schill
Lawyer
Frankfurt
felix.schill@gsk.de

Tim Florian Metzmeier
Lawyer
Munich
tim-florian.metzmeier@gsk.de

Stephan Wachsmuth
Lawyer
Munich
Stephan.wachsmuth@gsk.de

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www.gsk.de

GSK Stockmann

BERLIN
Mohrenstrasse 42
10117 Berlin
T +49 30 203907-0
F +49 30 203907-44
berlin@gsk.de

HEIDELBERG
Mittermaierstrasse 31
69115 Heidelberg
T +49 6221 4566-0
F +49 6221 4566-44
heidelberg@gsk.de

FRANKFURT / M.
Taunusanlage 21
60325 Frankfurt am Main
T +49 69 710003-0
F +49 69 710003-144
frankfurt@gsk.de

MUNICH
Karl-Scharnagl-Ring 8
80539 Munich
T +49 89 288174-0
F +49 89 288174-44
muenchen@gsk.de

HAMBURG
Neuer Wall 69
20354 Hamburg
T +49 40 369703-0
F +49 40 369703-44
hamburg@gsk.de

LUXEMBOURG
GSK Stockmann SA
44, Avenue John F. Kennedy
L-1855 Luxembourg
T +352 271802-00
F +352 271802-11
luxembourg@gsk-lux.com