

GERMAN TONNAGE TAX REGIME – INSIGHTS OF TAX AUTHORITIES' VIEW

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"After more than twenty years, the German tax authorities have replaced their original guidance."

Attention should be paid to the newly published guideline of the tax authorities on the German tonnage tax regime which provides further clarifications on related aspects (subject to final and pending court decisions).

The German tonnage tax regime (implemented in 1999) offers shipping companies a low lump-sum taxation on the profits from their international operations. The German tax authorities published guidance in 2002 on some matters on the

interpretation of the tonnage tax law (with few changes then being made to that guidance in subsequent years). After more than twenty years, the German tax authorities have replaced their original guidance. These changes relate mainly to court decisions and changes in law.

GERMAN TONNAGE TAX REGIME IN A NUTSHELL

Under the tonnage tax regime (section 5a Income Tax Act), businesses and individuals with seagoing vessels and place of effective management in Germany can – under certain conditions – elect to be taxed on the basis of a deemed profit related to the ship's tonnage.

"...changes relate mainly to court decisions and changes in law."

The application of the tonnage tax regime mainly requires that merchant ships operate in international traffic, ship management is carried out in Germany and an irrevocable application is filed in the business year during which the merchant ship was built or bought (commissioning).

MAIN CHANGES IN THE NEW GUIDANCE

Intention of long-term vessel operations

1.

Under case law, merchant ship(s) must be operated on a long-term basis in order to benefit from the tonnage tax regime. In underlying court decisions, the highest German tax court established presumption rules in this respect. This (unwritten) requirement is considered by the tax authorities within their newly published guidance in which they also consider the presumption rules. This comprises mainly the assumption that no long-term operation is intended if the respective vessel is sold within the commissioning year. In cases where the business comprises more than one vessel, the tonnage taxation shall apply to the (intended) long-term operated vessels only and not also for the short-term operated vessels.

2. Irrevocable application when a business comprises more than one vessel

It is unclear whether irrevocable application of the tonnage taxation must be filed for each vessel (vessel-related application) or just for the first vessel covering the entire shipping business (business-related application). The tax authorities are of the opinion that a business-related application is required, which is predominately the same view of other experts also.

The guidance contains further details on the tax authorities' view in this respect, including the consequences of an invalid application for a first vessel. If an application is invalid or a first vessel does not fulfil the (other) tonnage tax requirements, the shipping business shall be blocked from applying the tonnage tax regime for ten years. In this context, the tax authorities provide their view for some cases in which vessels can benefit from the tonnage tax regime and which not.

Therefore, care should be taken when setting up a shipping business with the intention to benefit from the tonnage tax regime. It should also be noted that there is a case pending before the highest German tax court with respect to the ten-year blocking period and a first vessel not fulfilling the tonnage tax requirements (IV R 7/22).

"There are still uncertainties on specific aspects of the German tonnage tax regime... Some aspects of the German tonnage tax rules are also challenged before a court..."

3. Depreciation after exiting the tonnage tax regime

The guidance now contains the tax authorities' view on depreciation under the regular profit determination rules after exiting the tonnage tax regime. According to the law, the assets must be accounted for at fair market value at the moment the regime is changed, but depreciable assets shall continue to be depreciated considering the amortised acquisition/production costs. This generally prevents the taxpayer from benefitting from a step-up of depreciation volume which is in contrast to former case law which had been accepted by the authorities for periods effective before the respective law has been amended.

According to the guidance, the depreciable volume shall, however, be reduced in case of a lower fair market value. This might be disputable.

4. Changes relating to shipping partnerships

Some changes comprise, *inter alia*, the alignment of amendments in law and other case law decisions with respect to shipping businesses in the legal form of a partnership.

For instance, the guideline considers the alignment of the rules on frozen hidden reserves in assets in case of a direct ownership change in the shipping partnership applying the tonnage tax regime. Such frozen hidden reserves are determined when the profit determination system is changed by applying the tonnage tax regime. If a partner resigns or their share in the shipping partnership is reduced, the allocated frozen hidden reserves shall generally be taxed in the amount of the partner's share in the partnership. According to the (amended) law, this taxation shall not arise in cases where the partner resigns or the partner's share is reduced by way of a transfer of his/her share (or a portion thereof) in the partnership to another person free of charge and at tax book value under section 6 para. 3 Income Tax Act.

Furthermore, the treatment of special partners' income for the years prior to the tonnage tax application year of a shipping business partnership is covered in the guidance following a court decision.

"...care should be taken when setting-up and applying the tonnage tax regime"

5. Other changes and additions

The new guidance contains further clarifications on certain tax matters when applying the tonnage tax regime, e.g. the non-consideration of certain tax adjustments which may apply when the profit is determined under regular rules. These statements were, to some extent, already published in another old guideline of the tax authorities dated 24 March 2000.

6. Application of the new guidance

The new guidance shall generally apply to all pending cases, though some exceptions apply to this.

PRACTICAL IMPACT

The changes and additions in the guidance are mostly welcome. However, there are still uncertainties on specific aspects of the German tonnage tax regime besides potential disputes on the new published views. Some aspects of the German tonnage tax rules are also challenged before a court which decisions may provide further clarifications such as on the lawfulness of retroactive amendments in law regarding the freeze of hidden reserves and questions on the extent of ship management activities required to be carried out in Germany.

Following this, care should be taken when setting-up and applying the tonnage tax regime. Also, new case law should be monitored.

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