

Minimum taxation: From GLoBe to Pillar 2 to the German Minimum Tax Act! What does it mean for investors and investment funds?

June 15, 2023

On March 21, 2023, the German Federal Ministry of Finance published a discussion draft for a law to implement the Directive to ensure a global minimum taxation of multinational groups and large domestic groups in the Union (*Mindestbesteuerungsrichtlinie-Umsetzungsgesetz*).

In this **beinformed** we want to look at and discuss the scope, generally referred to as scoping. Please note that we are discussing the German draft Act and that we do not necessarily use the English terms of the EU-directive.

At 89 paragraphs, the draft is already long enough, so we will briefly refer to the discussion draft as the Minimum Tax Act.

It applies to business units located in Germany that are part of a group of companies that report annual revenues of at least 750 million euros in the consolidated financial statements of the ultimate parent company in at least two of the four financial years immediately preceding the financial year (consolidated revenue test).



Documents to beinformed:

- [OECD Key Operating Provisions Checklist](#)

These entities form a so-called minimum tax group pursuant to Section 3 of the Minimum Tax Act. The tax is owed by the group parent. All business units included in the minimum tax group are jointly and severally liable for the group parent's minimum tax, Section 3 (5) Minimum Tax Act.

This beinformed deals with the scoping only. But very roughly, if a top parent company has e.g. a Hungarian corporation in its consolidated financial statements and the corporation pays only 9 percent corporate income tax there, the top parent as the group parent owes a top-up tax of 6 percent to reach a minimum tax of 15 percent.

At the beginning there is the determination of the minimum tax group

Pursuant to Section 4 (1) sentence 1 of the Minimum Tax Act, the minimum tax group (Group Entities) comprises all entities (Constituent Entities) that are related to each other through ownership (permanent establishments) or control (other legally independent entities), so that the assets, liabilities, income, expenses and cash flows of these entities must be included in the consolidated financial statements of the ultimate parent company (full or proportionate consolidation).

The first requirement on the checklist is therefore consolidated financial statements with full or proportionate consolidation. This makes sense as a starting point for a worldwide minimum taxation of



business units regardless of the legal independence of the group entities. The business units become operating divisions of a „unitary enterprise“. In accordance with this unit theory, full consolidation is required. The items of the consolidated companies must be included in the consolidated financial statements even if the parent company does not hold all the shares. Inclusion in the minimum tax group is also linked to this unity theory (the actual calculation of the minimum tax is a different matter): those entities are included whose integration into the group is so strong due to control that the assets of the companies included are to be fully regarded as assets of the group as a whole. However, even in cases of joint control (50:50), consolidation is to be carried out, except that it is then not justified to recognize all assets in each of the two managing companies, irrespective of the shareholding. In this case, proportionate consolidation is used.

If a company is not fully or proportionately consolidated in the group in this sense, it is not included in the minimum tax group. However, if an entity is not required to prepare consolidated financial statements, a deemed consolidation must be prepared in accordance with a recognized accounting standard to determine whether the entity would have been required to consolidate the assets, liabilities, income, expenses and cash flows of the entities it controls (deemed consolidation test).

Special features in the case of investment funds

Here, then, there is already a special feature for investment funds. German investment funds report their assets at fair value, Section 168 of the German Investment Code. This type of reporting is also appropriate, as investors participate in the actual performance that has occurred during their respective holding period.

This also applies if the investment fund holds and controls real estate companies, for example. In this case, the controlled real estate company is not fully consolidated, but the investment in the real estate company is recognized at fair value. Thus, the companies held by a German investment fund do not belong to the minimum tax group with the investment fund as parent company, even in the case of control due to the lack of full or proportionate consolidation. This is also explicitly recognized: OECD (2023), Tax Challenges Arising from the Digitalisation of the Economy - Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), Example 10.1-2. This type of inclusion at fair value is recognized and therefore no deemed consolidation need to be prepared.

The special accounting treatment with inclusion at fair value is also in line with accounting under IFRS. Thus, IFRS 10, just like § 168 of the German Investment Code, also provides for investment entities (IFRS 10.27) to recognize their investments at fair value and not to consolidate the assets.

For investment funds in Luxembourg that do not prepare consolidated financial statements, we come to the same conclusion. However, as fair value reporting is not mandatory for these under Luxembourg law, we take the roundabout route of deemed consolidated financial statements under the IFRS standard here.

However, this does not exempt the investor from including the investment fund itself in its consolidation if it holds a controlling interest in the investment fund. Thus, an investment fund can be an entity in a minimum tax group of the investor (exception: investment fund as a so-called investment vehicle and is an exempt entity). The entities controlled by the investment fund are also included in the scope of consolidation, IFRS 10.33: „including entities controlled by the investment fund“. This also applies if the investment fund can be classified as an investment vehicle and is thus an exempt entity. The attribution of rights of the subsidiary to the parent company takes place irrespective of whether the subsidiary is included in the consolidated financial statements of the parent company or not (Beck Bil-Komm./Grottel/Kreher, 13th ed. 2022, HGB § 290 no. 80).



Special features for certain investors

Investors such as pension funds, corporations under public law, are not required to prepare accounts under the German Commercial Code. Pension funds themselves determine the accounting rules applicable to them in accordance with the relevant guidelines issued by their supervisory authority. As a rule, there is no obligation to prepare consolidated financial statements.

However, the obligation to prepare deemed consolidated financial statements in accordance with a recognized standard as described above then applies.

Here, however, a special exemption clause comes to the rescue. Pension funds are so-called exempt entities under Section 5 (1) no. 4 of the Minimum Tax Act – irrespective of the level at which they are located in the group of companies. They always fall outside the minimum tax group. Neither can they be the ultimate parent company and thus cannot be forced to prepare consolidated financial statements. Nor can they be included as controlling interests in the minimum tax group of another entity.

The term pension fund under Section 7 (24) (1) of the Minimum Tax Act includes an: entity established and operated to administer or provide retirement benefits and supplementary or ancillary benefits exclusively or almost exclusively to individuals who, as such, are subject to government regulation.

According to the explanatory memorandum, the phrase „almost exclusively“ means that such a pension fund may, to a very limited extent, also engage in activities that are not directly related to the administration and provision of retirement benefits and supplementary or ancillary benefits (for example, promotional activities for the pension fund). Supplementary or fringe benefits include, for example, death benefits, surviving dependents' pensions, wage replacement benefits in the event of long-term illness or unemployment, and subsidized loans for the purchase of a home.

So-called contractual trust arrangements should also be covered by this exception in Section 7 (24) (1) of the Minimum Tax Act, as entities: whose benefits are secured or otherwise protected by national regulations and are funded by a pool of assets held through a trust or trustee to ensure the fulfillment of the corresponding pension obligations in the event of the insolvency of the corporate group.

Special features of investment funds that qualify as investment vehicles

Investment funds may also be an Exempt Entity - unlike pension funds but only as the ultimate parent company. However, in addition to the general requirements comparable to those of Section 1 (1) sentence 1 of the German Investment Code, which every investment fund should meet, the exemption under the Minimum Tax Act only applies to investment vehicles with more than one investor, not all of which are affiliated with each other (Exempt Investment Vehicles, Section 7 (14) of the Minimum Tax Act). However, if the investment fund has a controlling company as investor, this investor is likely to be the ultimate parent company anyway. If there are two investors (not affiliated), the individual investment amount is irrelevant.

If, on the other hand, the investment fund is the ultimate parent company, it will probably not be a group of companies within the meaning of the Minimum Tax Act if its investments are accounted for at fair value (no consolidation) (excluding permanent establishments as suitable group units). Without a group, the investment fund falls outside the scope of application of the minimum tax.

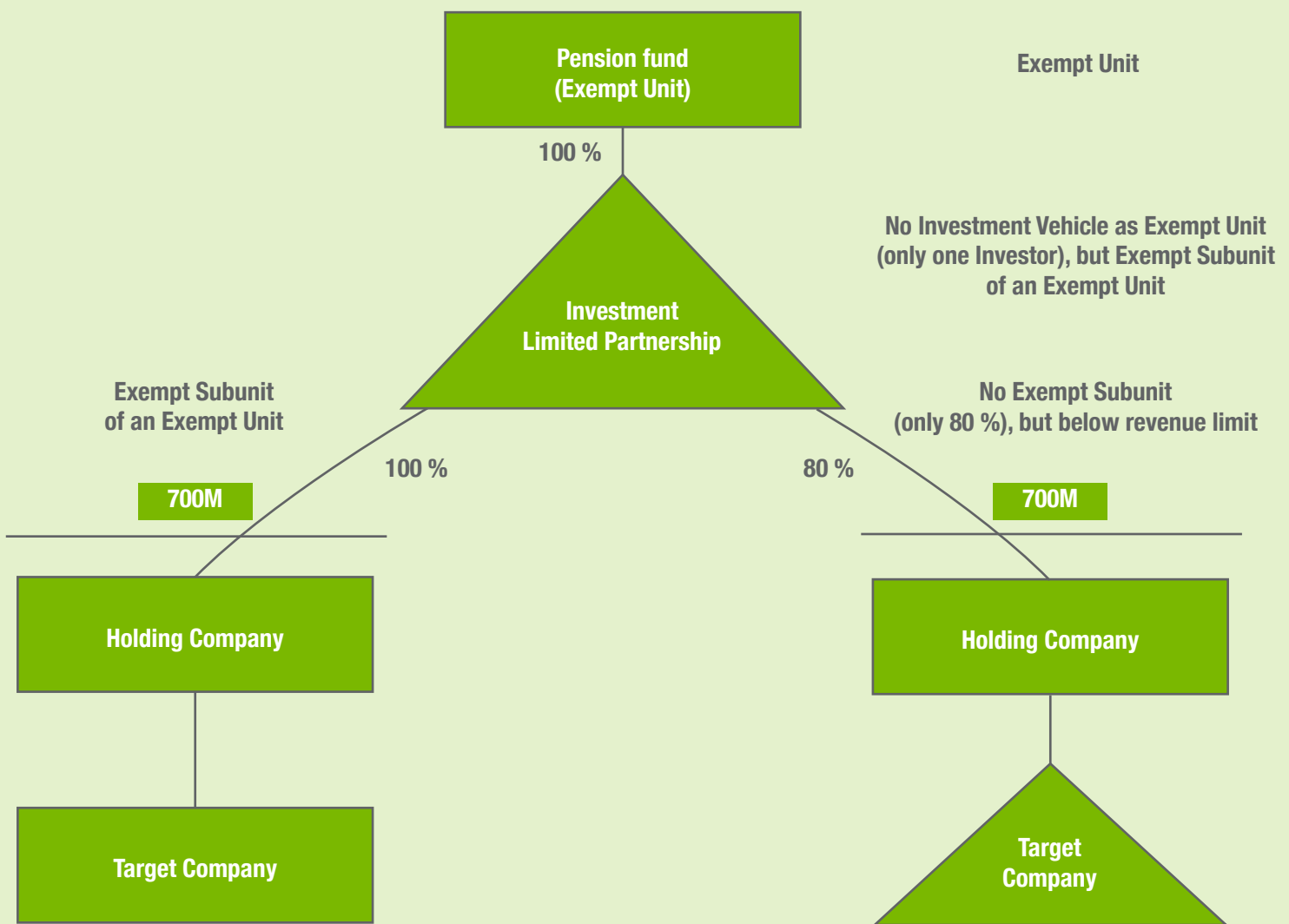
If an investment fund has the misfortune of not recognizing the companies it controls at fair value, but instead performs a full or proportionate consolidation according to the accounting standard it applies, these entities can probably – to our great surprise – together form a group. Here, the investment fund then relies on meeting the requirements for an Excluded Entity. This surprised us because under the deemed consolidation test, an investment fund that does not prepare consolidated



financial statements at all would not have to consolidate its investments if IFRS were applied as the recognized accounting standard, but would have to report them at fair value. Nevertheless, we read this result out of 2022 OECD Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two) Art. 1.5, Note 39.

Special features of certain real estate investment vehicles

A real estate investment vehicle is a widely held entity that holds predominantly immovable property and whose income is subject to one level of taxation, either on itself or, with no more than a one-year deferral, on its unitholders. Such a real estate investment vehicle is also an Exempt Entity if it is a top-level parent company. This is a catch-all exception to the Exempt Investment Vehicles. This means both Exempted Entities apply side by side without speciality (2022 OECD Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two) Art. 10.1, Note 144).



Exempt Subunits of Exempt Entities

If there is an Excluded Entity in a Minimum Tax Group, this does not mean that the investments held by this Excluded Entity are also excluded from the Minimum Tax Group. The scope of consolidation of the consolidated financial statements generally includes, in addition to the Excluded Entities, the investments held by these Excluded Entities. Only certain qualifying sub-units are also excluded:



- an entity that is at least 95 percent owned, directly or through a chain of such entities, by an Excluded Entity (investment test) and that is used exclusively or almost exclusively to hold assets or invest funds for such entities (activity test)
- an entity held at least 85 percent of its value by an Excluded Entity, provided that such entity earns income almost exclusively from dividends that are excluded from the calculation of relevant profits or losses for purposes of the Minimum Tax Law (dividend reduction amount of Section 19 of the Minimum Tax Law for nested holdings at least 10 percent and long-term holdings with a holding period of at least 12 months).

As a preliminary result, it remains to be stated that the investment fund itself should not owe a minimum tax. However, the situation is different for participations held by it. Especially in the areas of infrastructure, real estate and private equity, companies held by the investment fund could be affected if they themselves do not meet the classification as exempt subunits. This is not only a threat to the group in which the investment fund falls. If, for example, the investment fund makes investments together with other companies that are part of another non-EU group without minimum tax rules, it may also be liable for the minimum tax of the other group at the level of the jointly held investments. Investors as ultimate parent companies may also face increased reporting requirements.



be in touch: Any questions? Please do not hesitate to contact us!



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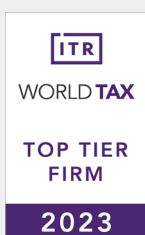
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