



MOORE

THOUGHT LEADERSHIP: TAX ASPECTS OF RENEWABLE PROJECTS



THOUGHT LEADERSHIP: TAX ASPECTS OF RENEWABLE PROJECTS

The higher emission targets under the European Union's (EU) Green Deal put great pressure on the economy, especially its energy- and resource-intensive industries. Companies face the challenge of setting themselves up as sustainable, future-proof and attractive investment projects.

Germany, the EU as a whole, and many other countries want to line the path to a climate-neutral continent with various industrial-policy measures. At the beginning of June 2020, the German government adopted an aid package amounting to EUR 130 000 million. This includes the expansion of renewable-energy sources, abolition of the cap on photovoltaics, and increasing the target for offshore wind power.¹

‘TRANSFORM OR DIE’

Before the outbreak of the coronavirus crisis, the EU announced a concerted growth strategy in the form of the Green Deal². Now the EU Commission wants to link the revival of the European economy closely to ecological transformation.

From a tax perspective, the introduction of a Europe-wide CO₂ tax has been a failure to date, especially due to the resistance of those EU Member States whose electricity and heat production is mainly based on coal. In the emerging age of decarbonisation, however, it is a case of ‘transform or die’. By 2030, the share of renewable energy in the EU could increase to 33.7%, which exceeds the current target of at least 32%.³ To remain an attractive investment, companies must include the reduction of CO₂ emissions as a fundamental corporate goal.

THE GERMAN PERSPECTIVE: A POSSIBLE TAX DEDUCTION FOR CARBON OFFSETTING

Many companies already want to make an active contribution to CO₂ reduction. This includes voluntary compensation payments (carbon offsetting). In this way, companies do not reduce their own CO₂ emissions, but create compensation elsewhere, for example by supporting sustainable projects, especially reforestation. It should be noted that the certificates which a company receives for its compensation payments are not an economic good. The compensation payments may be tax-deductible as a donation. However, the restrictions of section 10b German Income Tax Act (*Einkommensteuergesetz – EStG*) and section 9(1)(2) German Corporation Tax Act (*Körperschaftsteuergesetz – KStG*) are applicable for tax deduction. In the US, in contrast, if the payments are made to a section 501(c)(3) public charity registered with the US Internal Revenue Service, the entire amount of a carbon-offset transaction is tax-deductible for US residents.

WIND-POWER PLANTS AS AN INVESTMENT

The interest of investors in acquiring wind-farms located in Germany has increased steadily in the recent past. From a tax point of view, there are a number of special features to be taken into account for acquisitions by operating companies:

In particular, the division of trade tax revenue between the local authority in which the wind-farm is operated

and the local authority in which the company has its management has been and still is a frequent point of dispute between participating local authorities and wind-farm operators. Section 29 of the German Trade Tax Act (*Gewerbesteuerengesetz – GewStG*) codifies the trade-tax allocation as follows: 70% of the trade tax base is to be allocated to the local authority in which the wind turbines are located and 30% to the local authority in which the central management of the company is located (since the employees work there).

According to the German Federal Fiscal Court (*Bundesfinanzhof – BFH*), the acquisition costs of a wind turbine may only be written off from the time of the transfer of economic ownership. The economic ownership of a wind turbine is transferred to the buyer or purchaser only at the time of the transfer of risk.⁴

With regard to value-added tax, it should be noted that wind turbines are valued as fixed installations with a fixed structure and subsequently as domestic permanent establishments. The fact that a foreign company has no staff of its own who are permanently working on site at the wind turbines does not preclude the assumption of a fixed establishment or permanent establishment in view of the overall circumstances.⁵

GENERAL TAX TREATMENT OF WIND FARMS

Given the important role played by wind farms in Germany and elsewhere, it is worth outlining some aspects of their treatment for tax purposes in Germany, with special emphasis on tax structuring.

TAX LIABILITY OF OFFSHORE WIND FARMS

In the following we assume that the onshore wind farms in question are located on the territory of Germany. However, it is important in this context to determine the tax liability of offshore wind farms, as they may be outside German jurisdiction.

According to German domestic law, the territory of Germany also includes the part of the continental shelf belonging to the Federal Republic of Germany. It follows that liability to German corporate income tax and trade tax will apply to operators of such offshore wind farms.

OFFSHORE WIND FARMS AS A PERMANENT ESTABLISHMENT AND TREATY-LAW PROVISIONS

According to article 12 of the German General Tax Code (*Abgabenordnung – AO*), a permanent establishment (*Betriebsstätte*) is a fixed place of business or facility that services the operations of an undertaking. The term ‘permanent establishment’ according to German domestic law is thus – as in other jurisdictions – normally a little broader than the definition of the term in most double tax treaties and in the OECD Model Treaty (art. 5(2)).

Under art. 5(2) of the OECD Model Treaty, ‘permanent establishment’ is defined as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

From one point of view, therefore, since a wind turbine remains in a specific location, this constitutes a fixed place of business. At least in part, the business activity of the energy company is carried out by the wind turbine as a permanent business facility.

1). German Federal Ministry of Finance, ‘Emerging from the crisis with full strength’, <https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Public-Finances/Articles/2020-06-04-fiscal-package.html>.

2). Simon, ‘EU Commission unveils European Green Deal’, 2019, <https://www.euractiv.com/section/energy-environment/news/eu-commission-unveils-european-green-deal-the-key-points>, retrieved 29 December 2019, last accessed on 20 January 2021.

3). European Commission press release ‘State of the Union: Commission raises climate ambition and proposes 55% cut in emissions by 2030’, September 2020, https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1599, last accessed on 20 January 2021.

4). BFH decision of 22 September 2016, IV R 1/14.

5). Finanzgericht Köln, 14 March 2017, 2 K 920/14.

However, a careful analysis of the relevant double tax treaty provisions (assuming there is a treaty with the relevant jurisdiction) and of the respective domestic tax-law provisions must be undertaken and may lead to a different result. For example, German law contains section 1(1) EStG and section 2(7)(2) GewStG, which impose liability to those two taxes on offshore wind parks on the one hand, whereas the treaty with the United Kingdom contains art. 20, which provides that an enterprise of one contracting state (in this case, a UK enterprise) carrying on offshore activities in connection with the exploration or exploitation of the sea-bed, subsoil and their natural resources in areas recognised by international law as under the jurisdiction of the other contracting state (in this case, Germany) will, subject to certain exceptions, be taxable in that other contracting state (Germany). It is questionable whether an energy generator operating wind turbines would fall within this definition.

TAX-LOSS CARRY-FORWARDS DURING THE START-UP PHASE

Due to the high acquisition costs and costs for plant, property and equipment there will be – not only in the view of German tax law – a considerable cost basis for future depreciation. This together with especially the start-up phase of a wind farm may in many cases lead to the generation of tax losses, which may be enhanced by, for example, the application of special depreciation regimes.

Under German tax law – and this may also be applicable in other jurisdictions – a distinction is made when it comes to tax losses between the legal form of a company (e.g. a GmbH) and a partnership (e.g. a GmbH & Co. KG).

From a trade-tax point of view, it is possible to utilise start-up losses by offsetting them against profits in the profitable phase (loss carry-forward). In the case of partnerships, this may only take place once the partnership has commenced business. In the case of companies, tax losses may be utilised as soon as the company has been registered in the German Commercial Register, since companies are deemed to be trading once registered (section 2(2) GewStG).

There is one item that deserves to be mentioned in the context of tax planning around tax losses: Sometimes it may be that the accumulation of an ‘excessive’ amount of tax losses is unintentional on the part of the enterprise. Accordingly, in Germany

there exists an option to capitalise interest (incurred in relation to financing the construction of a wind farm) as so-called capitalised construction interest. This expense can then still be recognised via the subsequent depreciation of the asset that is the wind farm, the value of which would then have been increased by the capitalised interest. This or other-tax planning ideas should be evaluated in the respective jurisdiction. Two further aspects need to be considered in this connection: what is the treatment under company law (i.e. in the commercial balance sheet) and how long is the period (and is there a limitation on that period) for utilising the tax losses? Under German law, there is no limitation and tax losses may be carried forward for an indefinite period.

DEPRECIATION METHODS

Another important question in this context is depreciation of the bundle of assets that is a wind farm. In principle, a wind farm is not a uniform homogeneous economic asset. On the balance sheet, therefore, a distinction needs to be made between:

- the wind turbine with transformer
- external cabling including transfer station to the high-voltage network
- access (such as the approach to the wind farm)

We strongly recommend carefully checking the depreciation regime. Especially now during the coronavirus crisis, some countries (like Germany) have reintroduced the possibility of accelerated depreciation; other special depreciation regimes may also exist (such as section 7g EStG, which provides for an additional amount of depreciation under certain circumstances).

Another important topic in practice – and here one may need to distinguish between offshore and onshore wind farms – is the question over which period (or, by extension, at what rate) a wind farm or its major components may be depreciated. It will of course normally be in the interest of an enterprise to write off the depreciation expense as soon as possible (at the greatest rate), so a shorter period would be preferred over a longer one. In Germany, case law suggests a uniform period of 16 years (equivalent to an annual straight-line rate of 6.25%) may be appropriate for onshore wind-farms.⁶

Another query that will need to be answered is when exactly does this depreciation period start?

Depreciation normally runs from the acquisition date if the wind farm is acquired or from the point in time when it is ready to generate electricity, if it is newly built by the taxpayer.

THIN CAPITALISATION AND THE INTEREST RESTRICTION

In Germany, as in many other countries, there exist thin-capitalisation rules (section 4h EStG, in conjunction with section 8a KStG). Interest expense incurred by a business is deductible to the extent of interest income but, over and above this, only up to 30% of the figure obtained by increasing the relevant profit by the interest expense. Exceptions apply, however. The interest restriction applies only where the interest expense exceeds EUR 3 million in the year in question and does not apply within a group of companies.

For tax-planning purposes, it is therefore necessary to provide the wind-farm operating company with both debt and a reasonable amount of equity in order to avoid non-deductible interest expense.

The moral is that care should be taken to ensure that the finance expense can be offset against profits. One item that may pay consideration is a so-called debt push-down. We shall come back later to this in the context of finding the best legal form for a tax group (*Organschaft*) under German law.

VALUE-ADDED TAX CONSIDERATIONS

As is the case for income tax law, one must also first determine which is the correct jurisdiction for VAT in relation to offshore wind farms. This is necessary in order to determine in which jurisdiction a supply (whether of goods or of services) is subject to VAT, i.e. where is the place of supply (see e.g. section 3(9) and 1(2)(1) of the German Value Added Tax Act (*Umsatzsteuergesetz – UStG*)).

This aspect is relevant to decide on the correct VAT treatment of services to and by the wind farm (see section 3a(3)(1) UStG as an example how to deal with so-called land-related services within an EU Member State).

In addition to that, in all EU Member States, the supply of electricity from the wind farm is treated as a supply of goods.

INCLUDING A WIND-FARM OPERATING COMPANY (GmbH) IN A TAX GROUP (ORGANSCHAFT)

A special feature under German income tax law (and, indeed, that of many other countries) is the possibility of including a subsidiary in a so-called tax group (*Organschaft*) for income-tax and trade-tax purposes (see section 14 et seq. KStG). This allows the losses of the subsidiary to offset profits at the level of the parent company and vice-versa. Although it is a matter of some dispute, in principle the German *Organschaft* applies to German-resident entities only, and not cross-border.

However, other countries, such as Austria, allow for tax groups that extend cross-border. The existence and scope of tax grouping is therefore one of the key topics to be checked when designing the tax structure of a cross-border wind-farm project.

COMPANY VS. PARTNERSHIP

Under German (and also e.g. Austrian) income-tax law a partnership is treated as transparent for its income tax profits. These profits are therefore determined at the level of the partnership but then allocated to the partners and taxed at partner level. In Germany, this holds good for income tax but not for trade tax. Therefore, the use of a partnership as opposed to a subsidiary company has the advantage that tax losses may be offset or pooled at the level of the partners without the need of an *Organschaft*.

SUMMARY

In conclusion, there are four main aspects of taxation to consider when implementing a wind-farm project, irrespective of in which jurisdiction the wind-farm is to be located:

- Legal form: company or partnership?
- Depreciation regime: when does depreciation start running; is special accelerated depreciation obtainable?
- Exit regime: a participation exemption will most probably only apply to a sale of a company and
- Tax grouping: is this available?

There are, of course, many other issues that also need to be addressed.

6). BFH decision of 8 November 1996, VI R 29/96; decision of the tax court of Lower Saxony of 29 January 2009, 10 K 333/07; BFH decision of 4 April 2011, IV R 46/09.

INVESTMENT IN PHOTOVOLTAIC SYSTEMS

Photovoltaics in Germany is a success story. The German Renewable Energy Sources Act (*EEG Erneuerbare-Energien-Gesetz*) played a key role in this ab initio. The core point of the EEG was and is that network operators are obliged to connect electricity generated from renewable-energy sources (especially photovoltaics, wind power and biomass power plants) to the electricity grid immediately, facilitating purchase of the fed-in electricity in return for remuneration at fixed rates.

The installation of a photovoltaic system is also supported by other funding programmes. First of all, it should be noted that some credit institutions encourage such an investment with comparatively low-interest loans. Furthermore, support is often provided by the local energy supplier.

Value-added tax issues are an essential aspect of investing in a photovoltaic system. If the operator of the system is classified as a taxable person, the input tax (input VAT) will be reimbursed by the tax office upon acquisition so that only the net amount has to be financed.

If a person who is already registered for VAT purposes sets up a photovoltaic system, the operation of the system is not registered separately for VAT. All economic activities of a person are taken into account once for tax purposes. The VAT consequences of operating the photovoltaic systems are then to be recorded in the advance VAT returns created for the other existing activities.

From an income-tax point of view, the operation of a photovoltaic system generates commercial income. The tax office must be informed only informally of the start of the commercial activity.

The installation of a photovoltaic system is principally subsidised by the investment-deduction amount (German: *Investitionsabzugsbetrag*) if requirements with respect to the size of the company and the timing of the investment are met. This consists of the possibility of deducting an amount equal to 40%

of the probable acquisition costs from tax within the three calendar years prior to the purchase of the system. In this respect, however, tax depreciation will be reduced later. The result is a clear pull-forward effect and the tax reduction if the investment deduction is claimed can already be used to finance the system.

In addition to depreciation, basically all costs that are economically caused by the operation of the photovoltaic system are to be included as operating expenses. These are, in particular, meter rental, financing interest, and maintenance as well as consulting costs.

Due to the depreciation and, if applicable, an investment deduction, there are regular tax losses in the first years of operation. These can be offset against other income, so that there is an immediate tax-saving effect.

GERMAN TRANSFER-PRICING ASPECTS

Since 2013, the taxation of permanent establishments (PEs) without staff has been associated with legal uncertainties. In response, on 17 December 2019, the German tax authorities issued guidelines for profit allocation to permanent establishments without staff (e.g. wind and solar power plants).⁷

Where, however, no personnel functions can be assigned to a PE, especially in the case of non-staffed PEs such as wind turbines and solar systems, under Germany's Permanent-Establishment Profit-Allocation Ordinance⁸ the allocation of no profit or, at least, a low profit to such a PE would be justifiable.⁹

In terms of transfer-pricing methodology, it should be noted that in practice it can quite frequently be seen that the cost-plus method applies to long-term delivery and service agreements.

INDEPENDENT POWER-PRODUCERS: CHALLENGES

An independent power-producer (IPP) is an entity that is not a public utility but owns facilities to

generate electrical power for sale to utilities and end-users. The current legislation in various countries makes it difficult for an IPP to enter into power-purchase agreements directly with local authorities. One possibility for an IPP is to enter into a power-purchase agreement directly with a commercial enterprise, as, for example, the Bio2Watt plant has with BMW.¹⁰ Potential IPPs have to face significant upfront costs in relation to administration, setting up company structures, professional advice and feasibility studies. Loan interest and tax-compliance fees are not of a capital nature so they can be carried forward until the tax loss has been fully utilised. On the other hand, plant-construction costs and grid-connection charges may be deductible by means of various capital allowances (tax depreciation), but only if a number of requirements are satisfied. Regulatory frameworks might constitute an explicit hurdle for procurement from IPPs. In order to minimise any hurdles, greater consideration should be given to the role of local authorities in renewable-energy planning.

PROBLEMS OR PROFITS DUE TO CORONAVIRUS

During the course of the coronavirus pandemic the lower house of the German Parliament (*Deutscher Bundestag*) promulgated the first Coronavirus Tax Aid Act on 19 June 2020. On 30 June 2020, the second Coronavirus Tax Aid Act was passed shortly thereafter.

The main features of these Acts were the reduction of value-added tax rates, depreciation relief, an increase in loss carry-back and other tax reliefs.

The investment period for investment deductions made in 2017 under section 7g EStG was extended from three to four years by the second Coronavirus Tax Aid Act. This extension is intended to increase the company's liquidity by reducing the tax burden.¹¹

For moveable business assets, such as a wind turbine, an accelerated depreciation method was introduced for 2020 and 2021.¹² This depreciation method is a declining-balance method. It should be noted that special depreciation available under section 7g EStG may be used in conjunction with declining-balance depreciation. However, the question must

be raised as to whether this option should actually be implemented. In any case, it is certain that a project must always be beneficial in its own right. Tax advantages cannot be the main reason, or even the only reason, for implementing a project.

With regard to section 8c KStG, it should be noted that depreciation might be used to generate carry-forward losses. However, the transfer of wind turbines within a group or to third parties also leads to hidden reserves due to special depreciation. Generally, carry-forward losses of an entity are lost if the majority of its shares is transferred. However, Germany – like other countries around the world – provides for an exception to this rule if there are sufficient hidden reserves. There is a good chance that this exception applies, since special depreciation increases the annual losses on the one hand while it automatically increases the hidden reserves of the depreciated asset on the other.

To meet the challenges of renewable projects a forward-looking and proactive policy is needed. The national and international uncertainty of the economic future makes the choice of the most appropriate transfer-pricing method more challenging and simultaneously more important than ever.

SVEN HELM

Global Chair, Transfer Pricing
Moore TK
Mannheim, Germany
+49 621 42508 25
sven.helm@moore-tk.de
www.moore-tk.de

7). VWGBsGa12 (*Verwaltungsgrundsätze Verfahren: Betriebsstättengewinnabgrenzung*), BMF letter from 17. December 2019.

8). *Betriebsstättengewinnabgrenzungsverordnung (BsGaV)*

9). Greil, 'Überblick zu aktuellen Entwicklungen im Bereich der Verrechnungspreise', IStR 2020, 927, 928; BR-Drs. 401/14, 46.

10). For an example of this in South Africa, see BMW Group press release, 'South Africa's Biogas Pioneer', <https://www.bmwgroup.com/en/responsibility/sustainable-stories/popup-folder/biogas-pioneer.html>, last accessed on 20 January 2021.

11). Lang, *Körperschaftsteuer Aktuell* 2020, IWS, S. 1.

12). For an overview, see Asen, 'New Accelerated Depreciation Policies to Spur Investment, 2020', <https://taxfoundation.org/new-accelerated-depreciation-policies-to-spur-investment-australia-austria-germany-new-zealand>, last accessed 20 January 2021.

MOORE GLOBAL NETWORK

We've spent more than 100 years serving clients through our professional services. For more information on how our global services could help your business thrive in a changing world, just get in touch.

CONTACT US

Find your nearest member firm at
www.moore-global.com

Or email:
marketing@moore-global.com



www.moore-global.com
