PKF

Accountants &
business advisers

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Editorial

Dear Readers,

Usufructuary arrangements in connection with potentially **tax neutral transfers of business assets** are currently raising a lot of questions. The Senates of the Federal Fiscal Court are contradicting themselves while the baffled tax authorities are maintaining a low profile and even the current specialist literature is not providing any guiding principles that are of practical relevance. Therefore, in the last issue of the newsletter for this year, we have selected this topic for our 'Focus' section. There we explain why, currently, the utmost caution is required with respect to reserving usufruct.

In the first article of our 'Tax' section, you can find out why the Cologne tax court has, quite rightly, complained that under German tax law, **taxpayers with restricted tax liability** are sometimes placed in **a less favourable position**. The court has submitted a case to the ECJ for a review and this could indeed be taken as a precedent for similar cases.

At present, almost no other type of tax is as affected by the rapid growth in e-commerce and e-archiving than VAT. In this respect, the second contribution in this section deals with the risks incurred when **selling through online marketplaces** and our third article discusses the **archiving of documents**. It is not uncommon for drivers of **company cars** to bear the **expenses** themselves; in the last article on tax, you can read about the conditions under which these costs can be **reimbursed**.

In the 'Accounting' section, we have compiled reasons and indicators for the cases in which the going concern assumption and therefore **going concern accounting** has to be abandoned.

Brexit is likely to represent the final blow for the Limited (Ltd), a company format imported from the UK, particularly as the so-called German enterprise company (***Unternehmergesellschaft***, UG) has constituted an alternative for some time now. To this end, in the 'Legal' section, we discuss the main issues involved when such a company matures and becomes a 'normal' German limited company (GmbH). You can then read about the (narrow) limits within which **video surveillance of employees** is permitted.

We hope that you will find the information in this edition to be interesting.

Your PKF Team

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FOCUS

Anticipated inheritance - Caution is required with respect to usufructuary arrangements

The transfer of business assets while reserving the usufruct is one of the structuring instruments that can be used for anticipated inheritance. In this respect, the Federal Fiscal Court (Bundesfinanzhof, BFH) recently surprisingly ruled that transfers of business assets for no consideration could only be tax neutral if the commercial activity of the business owner will be terminated. This has shattered the previous practice of business transfers. This is because if usufruct is reserved for the transferor then the structuring of this will determine whether or not a tax-neutral transfer of the business at its carrying value is indeed possible. In the event of a usufruct agreement that is 'harmful' (detrimental from a tax point of view), in the future, there would be a risk that hidden reserves would be realised.

1. Reserving the usufruct up to now ...

Transferring a business for no consideration while reserving the usufruct was previously conducted by applying the so-called Usufruct Decree of 2012. If usufruct is reserved then a distinction has to be made between a usufruct on the business and a usufruct on the income. A usufruct on the business shall be deemed to exist if the usufructuary runs the business him/herself for his/her own account and risk. A usufruct on the income from a business shall be deemed to exist if the person who has reserved a usufruct (and is the previous owner) is entitled merely to all or part of the income without running the business him/herself. Regular income from the transferred business would be allocated to the donor and the beneficiary in accordance with the usufruct agreement that has been concluded. The constitutive features include voting rights and other participation rights as well as having a share in the success or failure of the business.

... came with tax concessions when the transfer was made for no consideration

According to the case law and interpretations hitherto for the respective provisions of the German Income Tax Act, if a business is transferred for no consideration then the hidden reserves are not taxable only if all the essential business assets are transferred and the transferor terminates his/her activities. Transferring a business for no consideration while reserving the usufruct can also constitute a tax-exempt transfer. According to the rulings hitherto (particularly by the IVth Senate of the BFH), the discontinuation of the donor's commercial activities has not been one of the mandatory preconditions. Rather, it was sufficient if, after the transfer, the business itself was maintained (object-related interpretation).

2. The BFH's new viewpoint – The realisation of the hidden reserves of the transferred business assets ...

With its ruling X R 59/14 from 25.1.2017, the Xth Senate has moved away from the case law hitherto of the IVth Senate. The Xth Senate of the BFH placed special emphasis on the termination of the activities by the transferor in the case of a sole proprietorship. If the usufruct that has been reserved is on the business then the transferor continues his/her previous commercial activity and retains the fruits of this, namely, the profits from the business. From the perspective of the BFH, in the case of a usufruct on the business, the acquirer would not be able to carry out commercial activities. The transferor would continue to generate income from business activities and, from the viewpoint of the Xth Senate, would only cease his/her activities upon the expiry of the

A usufruct is often an important instrument in succession planning

usufruct. Therefore, a transfer for no consideration should be treated like a withdrawal and would result in the realisation of hidden reserves, which would be subject to profit tax.

... will have far reaching consequences

Generally, while taking the BFH ruling into consideration, the conditions for a tax neutral business transfer could be deemed to exist for a usufruct on income. The agreements relating to profits and possible voting rights would then have to be structured in such a way that the acquirer of the shares in the business would be able to exercise his/her rights pertaining to the company in a discernible manner and the transferor would have to noticeably cease his/her commercial activities.

However, in practice, a business owner frequently would not transfer his/her entire co-owner's shareholding, but keep back a part of it. This is because donors want to continue to engage in business activities, at the very least, with regard to this (reduced) co-owner's shareholding. The question that arises is whether or not, in these cases, it is possible to agree a transfer for no consideration of part of the co-owner's shareholding under usufruct. According to the wording of the German Income Tax Act, such a structure is indeed non-crucial because each co-owner's shareholding has to be assessed separately. By the same token, in its ruling, the Xth Senate contradicted not only the IVth Senate and the practice hitherto, but also the legal text.

The BFH ruling is currently complicating the structuring of anticipated inheritance arrangements by reserving the usufruct.

- It is still open whether or not a usufruct on income, at least, can still be non-detrimental for tax purposes if, with respect to the allocation of profits and voting rights, it is structured with due regard to the, from now on, stricter requirements.
- Furthermore, there is now uncertainty as to whether or not preferential treatment pursuant to inheritance and gift tax will be granted in the case of agreements where usufruct has been reserved.

3. Recommendation - No transfers by way of a gift where usufruct is reserved, for the time being

Up to now, the tax authorities have not indicated how they will apply the BFH ruling. An appeal lodged with the BFH relating to a similar case has been withdrawn. We recommend postponing cases of anticipated inheritance where usufruct is reserved and, instead, examining alternatives such as, e.g. pensions. Moreover, in order to protect against any additional charges, usufruct agreements that have already been concluded should be assessed from a tax point of view.

TAX

Job-related expenses of taxpayers with restricted tax liability under review at the ECJ

» **Who for:** Natural persons who generate (business) income in Germany but are neither domiciled nor ordinarily resident there (taxpayers with restricted tax liability).

» **Issue:** Under German tax law, taxpayers with restricted tax liability are frequently in a less favourable position than who have unlimited tax liability. Business expenses are indeed generally tax-deductible, however, taking into account special expenses in order to reduce the tax liability is, in some cases, excluded.

The ECJ similarly differentiates between a taxpayer's job sphere and his/her private circumstances. Germany should take into account the job-related expenses of taxpayers with restricted tax liability in order to reduce their liability, whereas there can be restrictions on the deduction of personal expenses. Nevertheless, in certain cases, there might be a difference between Germany and Europe with respect to the concept of job-related expenses.

In a recent case, a lawyer who was resident in Belgium had income that was taxable (to a limited extent) in Germany. Connected with this was the mandatory membership of a German pension scheme for lawyers into which he paid both compulsory contributions as well as voluntary ones. Those with unlimited tax liability would be able to reduce their liabilities by deducting these contributions as special expenses, however, those with restricted tax liability would not able to do the same because German lawmakers have classified such contributions as special expenses.

In the opinion of the Cologne tax court, this provision constitutes a violation of European law because, at the very least, the reason behind the compulsory contribution to the pension scheme lies in working as a lawyer and, therefore, in accordance with European law, it may be deemed to be job-related. This is in contrast with the special expenses classification of the German lawmakers. With respect to the voluntary contributions to the pension scheme, while the causal relationship is

less pronounced, nevertheless, it could likewise be possible. The Cologne tax court has submitted both issues to the ECJ for a review.

» **Recommendation:** With respect to the issue of expenses that can be deducted in Germany by taxpayers with restricted tax liability, the job-related aspect in accordance with European law is relevant and not the classification of the German lawmakers. The judgement of the ECJ could be significant not only for the case in question but, potentially, for contributions to own occupation disability insurance or for transfers of assets in return for pension benefits. German lawmakers likewise classify both of these as special expenses and preclude them from being deducted.

» **Please note:** The ruling of the Cologne tax court from the 3.8.2017 (case reference: 15 K 950/13) is available at www.justiz.nrw.de (German version only).

Internet commerce – The pitfalls of external marketplaces

» **Who for:** Businesses that sell goods through online marketplaces such as, e.g. Amazon.

» **Issue:** Selling through online marketplaces constitutes a growth market. Besides 'direct sales' through the Luxembourg-based Amazon EU S.a.r.l, retailers can also autonomously coordinate the sale and despatch of their goods in the 'Amazon Marketplace'. In the case of 'Fulfillment by Amazon (FBA)', Amazon itself handles the despatch of the goods. Businesses transport their goods to a German Amazon warehouse and, from there, Amazon takes over the additional logistics. The Amazon-Pan-EU-FBA model enables the company to despatch goods from warehouses within Europe. For this Amazon uses its European logistics network (mainly in Poland and the Czech Republic).

Using the online commerce platform harbours tax risks. When sending goods to private customers in a foreign country within the EU, for example, the so-called mail order regulation has to be applied. According to this, when the threshold of sales is breached then the place of supply becomes the country of the recipient of the goods, i.e. the business would have to invoice foreign VAT. Moreover, the business would be obliged to register for VAT in the country of destination and submit a tax return as well as transfer the foreign VAT.

» **Please note:** The threshold amount of sales varies from one destination country to the other and that is why you should check and monitor this separately for each country.

Taking the goods out of Germany (without selling them to Amazon) to a German Amazon warehouse is not relevant for VAT purposes, however, making use of the Amazon-Pan-EU-FBA service does have VAT consequences. Transferring goods from a German Amazon warehouse to another EU warehouse constitutes an intra-Community transport, i.e. the retailer has to declare a VAT-exempt intra-Community supply of goods "to itself" and, moreover, register itself for VAT in the warehousing country in order to declare the corresponding intra-Community purchase there.

Furthermore, deliveries from the foreign warehouse to German private customers then have to be invoiced at the VAT rate of the warehousing country, to begin with, unless the application of the threshold of sales is expressly waived, or if the threshold of sales is breached.

» **Recommendation:** The VAT effects of such cross-border transfers of goods as well as the additional costs due to foreign compliance provisions should be taken into account in the decision-making process for accepting the respective offer. Please do not hesitate to contact us if you require support for the implementation of foreign compliance provisions, too.

Safeguards are needed when business is supposed to flow through foreign warehouses

VAT refund procedure – Are duplicate copies sufficient?

» **Who for:** Businesses based in a foreign country that are entitled to deduct input tax in Germany.

» **Issue:** A business that was required to submit copies of invoices electronically made these not from the originals but, instead, from a document with the annotation "Copy 1". In the course of the VAT refund procedure, the German Federal Central Tax Office refused to allow the input tax deduction.

In its ruling of 17.5.2017 (case reference: V R 54/16), the Federal Fiscal Court (Bundesfinanzhof, BFH) has now

clarified that a duplicate made from the copy of an original does constitute a reproduction that is true to the original and is sufficient proof for a VAT refund because it should be regarded as an indirect duplicate of the original.

» **Recommendation:** In the event of disputes that concern assessment periods prior to 30.12.2014 you should invoke this BFH ruling.

» **Please note:** Due to a change in the legal situation, since 1.1.2015, input tax refund applications have to be accompanied by scans of invoices and import documents that are sent electronically. This is applicable to payments of € 1,000 (or € 250 in the case of fuels) (Section 61(2) of the German VAT Implementing Ordinance).

Providing vehicles for use – Offsetting expenses borne by employees themselves against the non-cash benefit

» **Who for:** Employees who use company cars privately and share the motor vehicle costs.

» **Issue:** Motor vehicle costs that are borne by an employee can reduce the value of the non-cash benefit. This is calculated either by using the driver's log book method, or by applying the so-called 1% rule and, where appropriate, deducting the costs borne by the employee.

This is on condition that the motor vehicle costs that are shared between the employer and the employee are specified in writing in the agreement on the provision of a vehicle for use, or in the employment contract.

- Motor vehicle costs that are eligible for offsetting may consist of: costs for petrol, insurance, repair and servicing, premiums for car owner's liability insurance and vehicle insurance, rent for a garage and a car-parking space, motor vehicle tax, rent for a car-parking space, car maintenance and car washing, or the costs for charging current.
- The following are non-deductible: ferry costs, road/tunnel user charges, parking fees, expenses related to passenger and accident insurance cover, on-the-spot warning fines, disciplinary fees and penalty charges.

Employers have to be provided with documentary proof of the costs that are borne by employees. Employers have to retain the documents as originals. There can be no objection if the employer uses the amounts for the previous year as a provisional assessment basis for the regular (monthly) taxes.

» **Recommendation:** The employee's share of motor vehicle costs should be set out in writing. Here, you should ensure that the costs that will be assumed by the employee do not exceed the value of the non-cash benefit because a negative amount will not be recognised (for tax purposes) as work-related costs.

» **More Information:** The above-mentioned provisions as well as case study examples can be found in a Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) circular from 21.9.2017 (case reference: IV C 5 – S 2334/11/10004-02); it was issued for the application of the more recent BFH case law (rulings from 30.11.2016, case reference: VI R 49/14 and VI R 2/15).

ACCOUNTING

Accounting on a going concern basis – When is a departure from the going concern assumption appropriate?

» **Who for:** Businesses whose ability to continue as a going-concern is in jeopardy because of factual or legal reasons.

» **Issue:** The measurement of the assets and liabilities that are shown in the annual financial statements should be performed under the going concern assumption, insofar as there are no factual or legal conditions that conflict with this. It can automatically be presumed that a business will be able to continue as a going concern if:

- it has generated sustainable profits in the past,
- it can easily access financial resources and
- there is no risk of an overextended balance sheet (a so-called implicit going-concern forecast).

If this is not the case then the following distinction has to be made.

(1) *Factual reasons* that could conflict with the going concern assumption are understood to mean economic difficulties that would ultimately require business activities to cease. Economic difficulties are, in particular, grounds for insolvency. However, the economic difficulties do not have to be quite so pronounced so that they already constitute a reason for insolvency as defined in the German Insolvency Code (*Insolvenzordnung, "InsO"*), but rather other financial or business circumstances could already cast doubt on the ability of a business to continue as a going-concern.

(2) *Legal reasons* would be, in particu-

lar, the opening of insolvency proceedings and fulfilling all the conditions of the provisions of the law and of statutes that could result in liquidation.

However, even the presence of the above-mentioned indicators would not necessarily be a reason to depart from the going concern premise but would, rather, necessitate a more in-depth analysis. In this regard, you would have to ask whether or not the business activities could not or should not continue any longer. Ultimately, the answer can only be given on the basis of a forecast that makes reference to all the conditions and the measures that have been initiated that are relevant for the continued existence of the business. Here, the forecast that forms the basis for a decision should cover a period of, at least, 12 months following the balance sheet date and, in the event of an advanced crisis, can be extended up to three years. Furthermore, events after the forecast period that are already known and which call into question the going concern assumption also have to be taken into account.

In its recent rulings, the Federal Court of Justice (Bundesgerichtshof, BGH) presumed that accounting based on going concern values is permissible if:

- a convincing insolvency plan on a going concern basis exists,
- the aim is a transferred reorganisation (asset deal) within the reorganisation period and
- it is possible, or may be assumed that, even after the opening of insolvency proceedings, the business activities can be continued, at least, for the forecast period.

» **Recommendation:** If a going concern basis is deemed not to exist any longer then a proper valuation would be necessary, taking into account all the circumstances of the individual case. There is no generally applicable rule that exists for this valuation problem. nTherefore, the more certain and/or closer the actual end of the business activities, the greater the need for a transition away from general valuation rules and towards a single asset cash value approach.

In view of the complexity of making an assessment as to whether or not a departure from the going concern assumption is appropriate and given the consequences of this, it would be advisable to seek professional help, at least in cases of uncertainty. Please do not hesitate to contact our reorganisation experts, they would be pleased to help.

LEGAL

Transition from a German ‘enterprise company’ to a fully-fledged German limited company via a capital increase (though cash payment)

» **Who for:** Managing directors and shareholders of a German enterprise company (*Unternehmergesellschaft*, UG).

» **Issue:** The UG is a corporation where you can choose the amount of minimum share capital from a range between € 1 and € 24,999. Founders of such companies usually select a share capital amount that is at the lower end of this range in order, subsequently, to be able to accomplish the “ascent” to the status of a German limited company (GmbH) with its minimum share capital of € 25,000. The capital increase can be carried out on the basis of profits that have been left in the company as well as through a contribution in kind or in cash.

In this respect, the Celle court of appeals (*Oberlandesgericht*, OLG), in its ruling of 17.7.2017 (case reference: 9 W 70/17) dealt with a case that concerned a capital increase through a cash payment by which an UG was established with share capital of € 2,000, which was contributed in cash. In the submission to the commercial register, the managing director had given assurance that the capital contributions had been made in cash in the full amount and were freely available. Four years later, the sole shareholder of the UG decided to increase the share capital to € 25,000.

In the course of this, according to the agreement, the shareholder was supposed to make a capital contribution in the amount of € 10,500 so that, together with the existing share capital of € 2,000, he would reach half of the 50% of the € 25,000 that would be required for a GmbH. In the submission to the commercial register, the managing director assured that the capital contributions of € 10,500 pertaining to the new shareholding had been made. However, the competent commercial register court viewed this assurance as being insufficient and refused registration.

The commercial register court was of the opinion that assurance was also required that the original capital contribution of € 2,000 was still freely available to the managing director.

The complaint made against that decision was successful. In the opinion of the OLG Celle, the assurance does not have to include information that the original share capital is still available; such a requirement would be excessive.

When is video surveillance in the workplace permissible?

» **Who for:** Employers who use technical surveillance equipment.

» **Issue:** Camera surveillance of employees in the workplace constitutes an encroachment on the constitutionally enshrined general right to protection of one's individual sphere of life (right to one's own image) and is only permissible within very narrow limits. A weighing up of interests is always necessary while adhering to the principle of proportionality.

There has to be a specific and justifiable aim for video surveillance of spaces that are accessible to the public and it has to be an objective that cannot also be achieved via less drastic measures. Generally, protecting property by preventing thefts is recognised as a legitimate aim here. However, those affected have to be made aware of the video surveillance by means of appropriate measures.

By contrast, the use of hidden cameras for covert surveillance is only permitted in spaces that are not accessible to the public and within very narrow limits. There have to be specific grounds for suspecting a criminal offence, or severe misconduct to the detriment of the employer. All other measures to uncover the truth will have to have been previously exhausted and to have yielded no results. Undercover monitoring for no reason is not permitted and could lead to the imposition of fines as well as to claims for compensation from those under surveillance.

Video surveillance of employees is permitted in exceptional cases only

» **Please note:** Furthermore, it also has to be taken into account that the works council has a right of co-determination with respect to the introduction and use of technical equipment that is intended to monitor the behaviour or performance of employees. No cameras may be installed without the consent of the works council

IN BRIEF

Restructuring Decree not legitimate even in so-called legacy cases

The Federal Fiscal Court (*Bundesfinanzhof, BFH*), in its ruling of 28.11.2016 (case reference: GrS 1/15), already decided that the so-called Restructuring Decree of the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) constitutes a violation of the principle of the legality of administrative actions. Subsequently, the BMF declared that the Restructuring Decree was still fully applicable in legacy cases where the creditors had definitively waived their debt claims by 8.2.2017. The BFH, in its rulings from 23.8.2017 (case references: I R 52/14 and X R 38/15) has now clarified that the Restructuring Decree cannot be applied in these legacy cases either.

» **Please note:** With Section 3a of the German Income Tax Act and Section 7b of the Industry and Trade Tax Code the German government has indeed created circumstances where tax exemptions would be available for "restructuring profits" (when creditors waive debt claims) (Federal Law Gazette (*Bundesgesetzblatt, BGBl*) I 2017 - p. 2074). However, these provisions have not yet entered into force because they are subject to approval by the EU Commission in line with the law on state aid. Moreover, under the statutory conditions of Sections 163 and 227 of the Fiscal Code of Germany, restructuring profits can continue to qualify for tax concessions.

Non-current intangible assets – Addendum from the IDW

Almost as an addendum to our four-part series in the issues 07-08/2017 to 11/2017, we would like to make you aware of the opinion statements on the recognition of non-current intangible assets that were recently revised by the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer*, IDW):

(1) Modification of software (IDW ERS HFA 11 amended version) - In the view of the IDW, the accounting treatment of expenses incurred in the course of this should be determined by the treatment of the expenses for the original software. This should apply irrespective of whether or not the economic risk of the successful realisation

of the extension or improvement measures lies with the software user or a third party.

(2) Expenses for preparatory activities (IDW ERS HFA 31 amended version) - If such expenses were incurred prior to the reporting date but it was not possible to capitalise them because of a lack of definition of the asset then, for reasons of simplicity, it should not be allowed for them to be (subsequently) recognised in a later period.

Foreign corporations without a German permanent establishment may not apply the 5% affiliation penalty

According to a Federal Fiscal Court (*Bundesfinanzhof, BFH*) ruling, from 31.5.2017 (case reference: I R 37/15), the so-called 5% affiliation penalty cannot be applied to foreign corporations who do not generate income in Germany because they do not have a permanent establishment there and within the framework of which business expenses could have an effect. The legal fiction under Section 8b(3) of the German Corporation Tax Act could only lead to an increase in the assessment base for corporate tax purposes if there were a business expense deduction that would also be subject to domestic taxation.

A letter-box address on an invoice is sufficient

A company's input tax deduction shall not be excluded if the supplier of the goods or services provides merely a letter-box address on the invoice. The ECJ decided this on 15.11.2017; according to this, and contrary to a Federal Fiscal Court (*Bundesfinanzhof, BFH*) ruling from 22.10.2015 (case reference: V R 23/14), it is not necessary for the supplier of the goods or services to provide the place of economic activity as the address. In the view of the ECJ, the purpose of the address is merely to be able to reach the business owner and this would also be ensured with a letter-box address. Therefore, it will still be possible to provide letter-box addresses on invoices.

New Federal Labour Court rulings on the minimum wage

(1) All payments made by employers that constitute remuneration in return for work that has been performed are appropriate for fulfilling the requirements in relation to the minimum wage. The Federal Labour Court (*Bundesarbeitsgericht, BAG*) decided this in its rulings from 6.9.2017 (case reference: 5 AZR 317/16 and 441//16) and 24.5.2017 (5 AZR 431/16); this includes, e.g. performance-related bonuses, premium payments as well as supplements paid for working on Sundays and public holidays.
(2) Moreover, the BAG, in its ruling from 20.9.2017 (10 AZR 171/16), clarified that collectively agreed supplements payable for night work should be calculated, at least, on the basis of the minimum wage even if the standard contractual hourly remuneration is lower.

AND FINALLY...

"The great thing about fact-based decisions is that they overrule the hierarchy."

Jeff Bezos, Founder, Chairman and CEO of Amazon, born 12.1.1964

Impressum

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