PKF

Accountants &
business advisers

# PKF newsletter 04|18

## Editorial

Dear Readers,

In the Focus section, we present the changes to **British criminal law relating to corporate tax offences** because, in particular, if businesses have connections to the UK then even violations by a German company could have huge repercussions. At the same time, it is tremendously important to set up a **tax CMS**. Firstly, in order to identify and assess foreign risks which arise from regulatory changes like in the UK here and, secondly, simply on the grounds of being able to prove that a compliance organisation is in place.

**Crowdfunding** is a type of financing that is modern and still emerging. In the 'Tax' section, we consider the tax treatment of the cash flows based on the function of the crowdfunding. In another contribution, we focus on the interaction between a **hidden profit distribution and a gift** in order, subsequently, to bring them up to date with respect to the issue of the **limitations on loss deduction**.

Next up, in the 'Legal' section, there is a summary of the technical and organisational measures that have to be implemented in order to ensure that, from May 2018, **personal data are properly processed**. In the report that follows we demonstrate that the small but subtle difference between the written form and the text form is of great significance for **employment contracts.**

In the Accounting & Finance section, we take a close look at **shareholder loans at** companies that are **at risk of insolvency** and, in the second report, we analyse how **provisions 'acquired'** in the course of transfers should be recorded in the balance sheet. We round off the range of topics in this edition of the PKF Newsletter with an overview of **two funding programmes** that can be accessed by **SMEs for consultations on digitisation issues.** If this triggers an impulse in you for a project requirement then please do not hesitate to contact your PKF consultant who will be pleased to hear from you.

Your PKF Team

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FOCUS

# Criminal law in the UK relating to corporate tax offences requires tax compliance management systems to be in place in Germany, too.

**Two new variants of the criminal offence relating to corporation tax came into force in the UK on 30.9.2017 - the so-called "Corporate Offence of Failure to Prevent Facilitation of Tax Evasion" (CCO). The ramifications of these new regulations, which are enshrined in the Criminal Finances Act 2017, will also be considerable for German businesses with links to the UK and, consequently, there is now a need for action.**

### 1. The variants of the new criminal offence and ...

A distinction is made between so-called UK and foreign variants of the criminal offence. In both cases it is assumed that

- tax evasion has been facilitated, or supported in a way that is relevant for criminal law, by a person associated with the business and
- the procedures put in place by the company to prevent fraud were not sufficient.

The UK variant covers the evasion of UK taxes and social security contributions. If foreign taxes are evaded then the foreign regulation applies if the tax evasion is a prosecutable offence under UK law and also under the law of the third country. A company shall be deemed to have the required so-called UK nexus if it has a link to the UK, although this link should be interpreted very broadly. It is already sufficient if a person associated with a company acted as an accessory to the evasion of foreign taxes in the UK. Therefore, it would already be presumed that a criminal offence had been committed if a German company had provided a service in the UK that facilitated or supported the evasion of foreign taxes.

### ... the group of people who will be affected

The new offences can only be committed by professional partnerships and corporations but not by natural persons. A company does not have to be based in the UK or operate there for it to belong to the group of norm addressees that are potentially liable to prosecution. Moreover, the taxes that have been evaded or reduced do not even have to be owed in the UK. It is already sufficient if foreign taxes have been evaded, thus, e.g. German tax. Persons that are deemed to be associated with a company that is able to establish a "UK nexus", in the above-mentioned sense, shall be not only the employees but also other persons who work for or on behalf of the company (e.g. subcontractors, consultants, suppliers and shared service centres). This broad interpretation has the effect that a "UK nexus", potentially, might not be immediately discernible and perhaps even not in the long term. Natural persons as well legal entities are included, therefore, e.g. subsidiaries, too.

### 2. Required preventive measures and the penalties as a consequence of failing to put appropriate procedures in place

The key amendment to the COO is that it is no longer necessary to prove specifically that the acts of individual operators within the company's organisational apparatus constituted aiding and abetting. From now on, it will be sufficient that the company had not put in place structures that would have prevented tax evasion. Essentially, the only basis that now still remains for a company's defence is proving that it had taken reasonable preventative measures. However, if other criteria have been fulfilled then having dispensed with adopting these measures would constitute a criminal offence.

The British tax authorities have produced official guidance that outlines specific arrangements for preventative measures. Accordingly, there are several principles that should be followed here and these are comparable, to some extent, with IDW PS 980 for Compliance Management Systems (CMS), which is a German auditing standard issued by the IDW (the Institute of Public Auditors in Germany).

- Concretely, this consists in, especially, identifying risks in the company and developing appropriate tailored preventative measures.
- Furthermore, a company's management, which should be involved in these measures, should operate a zero tolerance policy.
- Moreover, effective internal communication possibilities have to be set up for reporting violations and risks that are identified (e.g. anonymous channels for "whistle-blowers").
- Finally, there is a requirement to monitor and refine the existing systems on an on-going basis.

» **Please note:** Only micro-entities, where the above-mentioned measures would be regarded as being disproportionate, have the option of dispensing with the implementation of such measures without the consequence of this becoming grounds for prosecution.

**3. Sweeping penalties**

There is a wide range of sanctions available in the event of violations. For example, monetary penalties with basically no upper limits could be imposed. Moreover, there could also be ancillary penalties:

- exclusion from being awarded public contracts,
- confiscation orders, or
- encumberance with special restrictions in this respect.

» **Recommendation:** In the event of a violation, companies will be able to exonerate themselves from any charges if they can prove that they had put in place adequate preventative measures. It is recommended that companies, which cannot be regarded as micro-entities, that have connections to the UK should at least set up a tax CMS or, in the case of an existing CMS, have its effectiveness checked, by an independent auditor, with respect to the requirements of the British tax authorities. The aforementioned measures are all the more important, particularly, in view of the coming Brexit in March 2019. In the course of Brexit, considerable changes can be expected with regard to how companies with connections to the UK are taxed. Therefore, prior implementation of the appropriate preventative measures is strongly recommended.

» **More Information:** The official guidelines from the British tax authority - HMRC - are available at www.gov.uk.

*RA [German lawyer] Sebastian Thiel, Duisburg*

# TAX

## Tax implications of crowdfunding

**In the last few years, there has been a substantial increase in the use of crowdfunding as a way of financing projects, especially in connection with start-ups but also in the case of other types of projects. Moreover, a series of aspects relating to tax have now recently been clarified.**

**1. Financing through crowdfunding**

Crowdfunding is a form of fund-raising. Through the investments made by a large number of people (the 'crowd') it is possible to finance various projects, products and start-ups. Internet platforms - so-called crowdfunding portals - are used to present projects, specify the minimum sum required and determine the period in which this amount should be achieved. Depending on the organisation and the execution of the crowdfunding project a distinction is made as regards the tax treatment at the level of the parties involved (for a detailed presentation of the financing aspects cf. report on crowdfunding in the 12/2016 edition of our PKF Newsletter).

**Crowdfunding - Many people contribute different amounts of money**

Start-up companies use the traditional crowdfunding model for the realisation of new product ideas. In return for their support the financial backers receive something in return, e.g. in the form of the respective outcome of the project.

**2. Implications with respect to income tax law and donation law**

The proceeds constitute operating income for income tax purposes and will also be subject to VAT if no VAT exemption exists. As this is not a case of altruism, the payments may not be deducted as charitable donations.

By contrast, sponsors who finance social and charitable projects do not get any material or financial counter-performances. When the targeted amount has been collected then the funds are forwarded to the project organiser. The general statutory provisions on not-for-profit activities and donations apply to this model. This means that the payments will be recognised (for tax purposes) as donations if the project organiser is a tax-privileged body or legal entity under public law and the project is executed for its tax-privileged purposes in accordance with its statutes.

Please note: Under certain circumstances, crowdfunding could trigger gift tax. This would have to be assessed on the basis of the specific structure in each case.

**3. Crowdlending and crowdinvesting**

Other manifestations are "crowdlending" and "crowdinvesting".

- Crowdlending is an alternative to traditional bank borrowing. The conditions are mostly better than for bank loans. This capital inflow does not affect the operating result for tax purposes. The interest that has to be paid to the capital provider constitutes a business expense, however, the repayment does not.
- With crowdinvesting, the backer participates financially in the success of the project outcome. The investments have an equity-like character.

» **More Information:** The fundamental Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* circular on the implications of crowdfunding under the donations law, from 15.12.2017, is available at www.bundesfinanzministerium.de (German version only).

*StBin [German tax consultant]*
*Elena Müller, Nürnberg*

## Gifting in the case of a hidden profit distribution to a closely related party

» **Who for:** Shareholders of corporations as well as parties that are closely related to them.

» **Issue:** If the performance relationships between a corporation and its shareholder, or a party that is closely related to him/her, do not conform to the arm's length rules and are at the expense of the corporation (e.g. property that is provided to the corporation at an inflated rent level) then, for income tax purposes, the portion that is on non-arm's length terms will be deemed to constitute a 'hidden profit distribution'. For a number of years now, the tax authorities have held the view that a hidden profit distribution can be, at the same time, a gift from the corporation to its shareholder, or to a party that is closely related to him/her. With respect to the question of whether or not the presumption of gifting is justified in such cases, the Federal Fiscal Court (Bundesfinanzhof, BFH) recently stated its opinion in three rulings, from 13.9.2017, (case reference: II R 54/15; II R 32/16; II R 42/16) as follows:

**(1) Not a gift from the corporation** - A hidden profit distribution does not constitute a gift from the corporation to a closely related party if the shareholder was involved in the conclusion of the agreement (e.g. rental agreement) between the corporation and the closely related party. In such a case, the granting of an (undue) advantage is based on the corporate relationship between the German limited company (GmbH) and the shareholder. The shareholder's involvement could already consist in him/her

- concluding the agreement in his/her capacity as a shareholding managing director,
- co-signing in his/her capacity as a shareholder,
- issuing an instruction to the managing director with respect to the conclusion of the agreement,
- working towards the conclusion of an agreement in some other way,
- or giving his/her approval for this.

**The shareholder, gifting and a hidden profit distribution in a relationship triangle**

**(2) A gift from the shareholder** - The BFH pointed out, however, that the hidden profit distribution could constitute a gift from the shareholder to the closely related party. Whether or not this is the case depends on the structure of the selected legal relationship between the shareholder and the closely related party. Various arrangements are possible here (e.g. a gift agreement, a loan, a purchase agreement).

From a tax perspective, this is what happens in the case of an existing hidden profit distribution. The company makes a (hidden) profit distribution to the shareholder, i.e. the payment is made with regard to the shareholder's rights under the company agreement. Subsequently, the shareholder gives the benefit that has been obtained to a closely related party. This transfer of assets could constitute a gift depend-

ing on the form of the legal relationship between the shareholder and the closely related party. The payment itself is made through the non-arm's length consideration by way of a direct payment from the company to the closely related party.

» **Please note:** The upshot is that, in most cases, the administrative opinion to-date and the view of the BFH, in equal measure, lead to the presumption that a hidden profit distribution to a closely related party usually constitutes a gift.

*StB [German tax consultant]*
*Steffen Heft, Heidelberg*

## Limitation on loss deduction for corporations - The Federal Ministry of Finance has pushed back against this

» **Who for:** : Corporations with tax loss carry-forwards.

» **Issue:** According to a ruling of the Federal Constitutional Court *(Bundesverfassungsgericht, BVerfG),* the partial non-recognition of a loss in the case of the acquisition of shareholdings is not compatible with the principle of equality and the court has called for new legal provisions. The constitutional court is also supposed to give a ruling on full non-recognition (cf. PKF Newsletter 10/2017). According to the BVerfG, a separate examination would be required to determine if a different assessment would ensue because of the introduction of the loss carry-forward tied to the continuation of a business in accordance with Section 8d of the German Corporation Tax Act (*Körperschaftsteuergesetz, KStG*), which took effect from 1.1.2016 (cf. PKF Newsletter 1/2017).

On 28.11.2017, the Federal Ministry of Finance (*Bundesministerium der Finanzen, BMF*) published a revised letter of implementation about Section 8c of the KStG (case reference: IV C - S 2745-a/09/10002:004). According to this, in view of the above-mentioned BVerfG ruling, Section 8c(1), clause 1 of the KStG should not be applied to shareholdings in corporations that were directly acquired prior to 1.1.2016 until new legal provisions are in place.

» **Recommendation:** The recommendation that we already made in issue 10/2017 still applies - you should lodge an objection against notices of assessment with limitations on tax loss deduction due to transfers of shareholdings of more than 25% and request a suspension of proceedings.

*StBin [German tax consultant]*
*Sabine Rössler, Duisburg*

# LEGAL

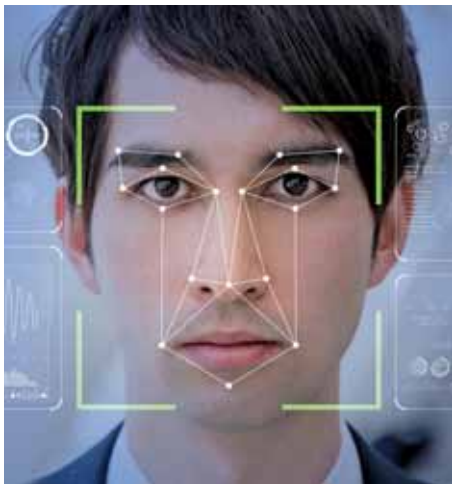
## General data protection regulation with sweeping obligations as regards organisation and information

» **Who for:** Companies with personal data processing.

» **Issue:** From the 25.5.2018, the General Data Protection Regulation (Datenschutzgrundverordnung, DSGVO) will apply to the processing of personal data. The aim of this legislation is, on the one hand, to ensure that within the EU personal data is protected and, on the other hand, to guarantee the free movement of data within the European Single Market.

A new element is that appropriate technical and organisational measures to ensure proper data processing have to be implemented and documented. In particular, this includes:

- setting up a data processing registers that document the purpose of the respective data processing;
- developing emergency plans for "data mishaps";
- preparing plans for deleting data if requested to do so by the person(s) concerned as well as once the mandatory record keeping periods expire;



**Personal data need a data protection system**

- ensuring that only those data are collected that are actually necessary for the stated purpose (this should already be ensured via the default settings of the IT system - 'privacy by design');
- complying with information obligations towards persons affected by the data processing.

The above-mentioned measures mean that a data protection compliance system will be required for the processing of personal data. Moreover, in view of the information obligations, the privacy policies that are used in the GTC or on websites will have to be reviewed and, if necessary, amended.

Furthermore, you should bear in mind that the sanctions for non-compliance have been drastically tightened.

A breach of the technical and organisational obligations (e.g. documentation) could result in the imposition of monetary penalties of up to €10 m or 2% of global turnover and a breach of material obligations could even result in penalties that are double this.

» **Recommendation:** Against the background of the massive threat of sanctions, it would be advisable to focus, at an early stage, on the issue of the implementation of the requirements of the DSGVO.

*RAin/StBin [German lawyer and tax consultant] Dany Eidecker, Osnabrück*

## Invalid exclusion clauses in employment contracts

» **Who for:** Employers who use exclusion clauses in employment contracts.

» **Issue:** Many employment contracts contain so-called 'exclusion clauses'. These regulate that any claims arising out of the employment relationship will lapse if they are not asserted in writing against the other contracting party within a specific preclusive period (frequently three months).

Since the coming into force of the German Act to Improve the Civil Enforcement of Consumer Protection Provisions of Data Protection Law, on 1.10.2016, it has been sufficient to assert a claim via a fax, an e-mail or a text message instead of a signed letter. The act applies to all employment contracts that were concluded after 30.9.2016. Moreover, it applies to 'old contracts' if their integral components (such as, for example, working time, area of responsibility, or remuneration) were amended in such a way that, all in all, there is now a new contract. If an exclusion clause in such contracts provides for the written form then this would lead to the exclusion clause being deemed to be unenforceable with the consequence that the short time limits that are defined there would not apply to the employee. The latter would then be able to assert his/her claims within the statutory limitation period (usually three years).

However, the claims of an employer lapse within the short time limit, even if the exclusion clause is unenforceable, if an employment contract has been based on the employer's pre-formulated standard contract. In such a case, the employer may not then invoke the unenforceability of the clauses that it used.

» **Recommendation:** Employers should review their standard contracts. Should an exclusion clause be used when contracts are amended or employment contracts are newly concluded then, for the assertion of claims, the contracts should provide for the text form instead of the written form. We would be pleased to help you with the wording of employment contract clauses.

*RAin [German lawyer] Claudia Auinger, Nuremberg*

# ACCOUNTING & FINANCE

## Shareholder loans - No waivers through the liquidation of a company

» **Who for:** Corporations that wish to liquidate subsidiaries without a debt waiver.

» **Issue:** Generally, the liabilities that a corporation owes to the shareholder should be written off in the income statement if the loan is of no value and the shareholder has waived the repayment of the loan. Up to now, it had been unclear whether or not the decision to liquidate should be regarded as such a waiver declaration. However, now the Frankfurt/M regional tax office (Oberfinanzdirektion, OFD) in its decision from 7.9.2017, recently clarified that a liquidation resolution alone should not be deemd to constitute a waiver declaration if the liability continues to exist under civil law until the conclusion of the liquidation (reference for the decision: A 12 St 525).

Agreements according to which creditors subordinate their debt claims below those of all other creditors in a way that the debts would only have to be serviced out of the debtor's future profits or free net assets establish an economic encumbrance for the company and a basis for the recognition of the liability. This applies until the winding up of the company has been completed. According to a more recent ruling of the Federal Court of Justice (Bundesgerichtshof, BGH), (for example, the most recent judgement from 5.3.2015, case reference: IX ZR 133/14) the condition for a subordination that has the effect of avoiding insolvency is that the shareholder's claim may not be satisfied if, in this way, the company would become over-indebted (freezing of payments). However, according to the OFD Frankfurt/M., this has no impact on the treatment of the loan in the financial and tax accounts. Even during insolvency proceedings, it should be assumed that the shareholder loan is an economic encumbrance and, therefore, that there would be a requirement to recognise it. Once the liquidation has been completed then the company's liabilities can

cease to exist without a taxable profit having arisen in the company's last logical second. However, - according to an explicit reference by the OFD Frankfurt/M. -, the valuation of the liabilities in the final accounts prior to winding up a business should be reviewed in each specific case.

» **Recommendation:** Cash allowances in the capital reserve for the repayment of liabilities serve to avoid having an impact on profits. Mergers are an alternative to problematic liquidations. If subordinations are agreed these should be examined with respect to their impact on the balance sheet.

*StBin [German tax consultant]*
*Sabine Rössler, Duisburg*

## The 'acquisition' of provisions in the case of transfers

» **Who for:** Businesses that prepare accounts and that have liabilities and provisions (such as, e.g. provisions for anticipated losses and pension provisions) in the case of an assumption of liabilities, an accession of debt and the assumption of responsibility for fulfilling an obligation arising from an individual transfer or a business transfer.

» **Issue:** In its circular from 30.11.2017, the Federal Ministry of Finance (*Bundesministerium der Finanzen, BMF*) published its definitive view with respect to the application of two legal provisions, introduced in 2013, namely Section 4f and Section 5(7) of the German Income Tax Act (*Einkommenssteuergesetz*, EStG), which concern the restriction on the realisation of hidden encumbrances when liabilities are transferred (case reference: IV C - S 2133/14/10001). The provisions apply to financial years ending after 28.11.2013. In the opinion of the tax authorities, in previous years, the Federal Fiscal Court (*Bundesfinanzhof, BFH*), through its more recent ruling, had facilitated tax revenue losses in the billions.

**(1) Legal framework since 28.11.2013** - Under the new legal provisions, the transferor may spread across 15 years any potential expense arising from the difference between the amount recognised for a liability in the financial accounts and the one in the tax accounts (Section 4f EStG). On the first balance sheet date following the transfer, the transferee has to recognise the liability in the tax accounts at the lower value at which the original obligated party had recorded it in its accounts; the gains that arise can be spread over 15 years (Section 5(7) EStG).

**(2) The view of the tax authorities -** The BMF has clarified that the ability to spread expenses applies solely to the transfer of liabilities that already existed on the preceding balance sheet date and that, for the transferee, fall under the scope of application of Section 5(7) EStG. If a liability that has been assumed is withdrawn from the transferee's business assets before the next balance sheet date then the gain that arises may not be allocated on an accruals basis. In the sphere of pension liabilities, transferees are able to exercise tax-related options independently from the option selected by the predecessor-in-title.

Please note: In the context of a pension commitment, changes in the funding vehicle (defined benefit scheme, provident fund, pension fund, or similar) are not subject to the application of Section 4f and Section 5(7) of the EStG.

**(3) Exceptions -** If a pension scheme beneficiary moves to a new employer then the spreading of the expense from the transfer of the liability ceases. This also applies to the transfer of anniversary bonus commitments, partial retirement agreements, or similar. The liability will be calculated separately by the transferee on the basis of the net present value of the pension obligation. However, these exceptional provisions do not apply in the case of legal transfers of pension obligations pursuant to Section 613a of the German Civil Code.

» **Recommendation:** To ensure the optimum taxation of the expense and income items that ensue from the transfer of liabilities we strongly recommend creating appropriate structures under civil law to this end, for example, for business transfers.

*StBin [German tax consultant]*
*Sabine Rössler, Duisburg*

## Push through the digitisation of your business with programmes that fund consultancy services

» **Who for:** Self-employed persons and business undertakings that employ less than 100 staff and whose reported revenues or total assets did not exceed € 20m in the previous year, or companies that are already active in the market and, moreover, fall within the scope of the EU definition for small and medium-sized enterprises (SMEs).

» **Issue:** The digitisation of business processes constitutes a huge challenge for companies. However, there is frequently a lack of financial options and know-how. In the following section we give an overview of two German federal government funding programmes that play a major role in the topic areas of "business consulting" and "management consulting".

**(1) "go-digital"** - This funding programme aims to facilitate access to expert advice as well as support for the benefiting business for the implementation of the measures required for

the setting-up and expansion of IT systems. In order for a consulting project to receive funding it has to be possible to assign it to one of three modules: IT security, digital market development or digital business processes. The funding is granted as a non-repayable subsidy in the form of partial funding for the consultancy firm's invoice. This can amount to a maximum of 50% of the daily rate for the consultant, which is limited to € 1,100. A maximum of 30 consultant days may be taken into account.

**Consulting expenses can be financed through funding programmes**

**(2) "Förderung unternehmerischen Know-hows" (Advancing business know-how)** - This programme makes a distinction between start-up companies (< 2 years after formation), existing companies (from 3 years after formation) as well as companies in difficulties. Start-up companies and existing companies can benefit from consultations on general and specific topics. Companies in difficulties can obtain funding for consulting on how to safeguard their businesses and follow-up consultations. The amount of the subsidy will be based on where the company is located and the maximum amount of consulting expenses that are eligible for a subsidy in each case. For start-up companies this is € 4,000 and for all other companies this is € 3,000.

» **Recommendation:** You should ensure that the consultancy firms satisfy the relevant conditions so as to be able to guarantee that the consultancy services will indeed be subsidised. In particular, you should bear in mind that the costs for consultancy services provided prior to the approval of your grant application will not be accepted.

» **More Information:** We would be happy to meet with you to discuss the conditions for funding programme applications. You can find more information (in German) on "go-digital" at www.innovations-beratung-forerderung.de, and on "Förderung unternehmerisches Know-how" at www. bmwi.de.

*B.A. Alessa Krüll and WP/StB [German public auditor/tax consultant] Martin Wulf, Stuttgart*

## AND FINALLY...

"The most dangerous poison is the feeling of achievement. The antidote is to every evening think what can be done better tomorrow."

**Ingvar Kamprad, founder of the furniture corporation IKEA, 30.3.1926 – 27.1.2018.**

**Impressum**

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