PKF

Accountants &
business advisers

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Editorial

Dear Readers,

Bitcoin owes its current fame less to its importance as a virtual currency for business but rather to the phenomenal appreciation in its value - an 18-fold increase in 2017 -, which was followed by a 60% fall in the price by March 2018. In the Focus section you can read about how bitcoins are created and about the tax treatment of the expenses and income associated with mining.

After almost six months of political deadlock a **new German government** has been formed and now, relatively quickly, has formulated its **tax policy objectives**, although no mention has been made of a tax reform. In the first contribution in our 'Tax' section, you will find an overview of the - rather selective - proposed changes as per the coalition agreement. Subsequently, we discuss the amended **VAT regulations** that will have to be heeded by **advisers for land and property transactions** and by the recipients of such services if they wish to safeguard their input tax credits.

We begin the 'Legal' section with information about the upcoming **works council elections**. The next two reports are about clauses. Firstly, in relation to the possible collective bargaining coverage in the case of the **transfer of an undertaking** that could prove to be costly, particularly, if the desired outcome was supposed to be a lower wage level. After that we discuss **post-contractual non-compete clauses**. Here, too, a notice of termination should not be used as leverage, at any rate, not if you still wish to receive remuneration.

In the Accounting & Finance section, we highlight an apparently incongruous legal situation when performing a **valuation for inheritance and gift tax purposes** that has now been confirmed by a Federal Fiscal Court ruling. If the value of a business has to be recorded on the basis of its net asset value then a (deferred) tax liability should not be recognised, however, if the company were to be liquidated then this would indeed be the case.

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

Your PKF Team

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LATEST REPORTS

Constitutionality of interest on tax arrears

The Federal Fiscal Court, in its ruling from 9.11.2017 (case reference: III R 10/16), decided that despite the prolonged low interest rate phase, the standardised interest rate laid down by law - since 1961 - of 6% p.a. for tax arrears and tax refunds was consistent with the constitution because the interest rate works both in the favour and to the detriment of taxpayers. According to this, the interest rates for investments as well as for financing should be used to assess the appropriateness of the interest rate for tax arrears/refunds. Given that, in 2013, the relevant comparable interest rates were in a range from 0.15% to 14.7% the statutory interest rate of 6% was indeed within the range of these realistic reference values.

Supplies via consignment stock – Federal Ministry of Finance has extended the period for transitional arrangements

In its circular from 10.10.2017, the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) adopted the recent ruling of the Federal Fiscal Court (Bundesfinanzhof, BFH) concerning the VAT treatment of deliveries from abroad via consignment stock in Germany and amended the VAT Application Decree accordingly (PKF Newsletter 1/2018). According to this, from a VAT perspective, a direct supply (transport or dispatch deliveries) shall be deemed to have occurred if the customer is already known at the beginning of the transfer operation and if the goods are temporarily stored in a consignment warehouse for just a short period. The BMF circular should be applied as of 1.1.2018 to all open cases. However, according to a BMF circular from 14.12.2017, there will be no objections if the hitherto valid regulations are applied to supplies made prior to 1.1.2019. Businesses that are affected will thus have the opportunity, until 31.12.2018, to clarify the VAT treatment or future contractual arrangements and logistical processing of such supplies.

FOCUS

Bitcoin - Virtual gold miners and their taxation in the private and business spheres

Bitcoin has been experiencing growing awareness since its rapid price increase in 2017, at the very latest. At the same time, the price has been extremely volatile. In the course of 2017 it went up from € 930 to € 16,892 (the all-time high in mid-December 2017) and then plummeted back down by mid-March 2018 to € 6,656. As a result of the proliferation of this currency and in view of the capital gains and losses associated with it, issues relating to the appropriate tax treatment have gained significantly in importance.

1. 1. Bitcoin – what is it?

Bitcoin is a so-called cryptocurrency, i.e. a digital means of payment, which is created and transferred in accordance with the principles of cryptography (= the science of information encoding). A special feature of cryptocurrencies is that they are not managed by a central bank or a similar institution but, instead, all transactions are executed via a decentralised network of the users' computers. Users receive remuneration in the form of bitcoins both from transaction fees as well as via the creation of new bitcoins through the process of "mining". These bitcoins can then be converted into other (crypto)currencies on a cryptocurrency exchange.

Mining is thus the basic module of bitcoin technology. Here, all the transactions have to be recorded and managed in batches of so-called blocks. A confirmed block will then be added to the so-called blockchain, which is a type of virtual ledger. For security reasons, a block can only be added after encryption with a so-called hash - a unique string of letters and numbers. This hash is retained at the end of the blockchain. Each time that someone successfully generates a hash s/he receives (currently) 12.5 bitcoins.

2. Taxation in the case of private individuals

The bitcoin value creation process

The sale of bitcoins is generally not taxable if more than 12 months elapse between the purchase and the sale (the speculation period). If the sale is executed only after the speculation period has expired then neither the gains nor the losses will be taken into account for tax purposes. A taxable gain or loss that arises from a sale during the speculation period is calculated here as the difference between the sale price and the acquisition costs. Any selling costs, e.g. exchange trading fees, will reduce the gain. The gain will be tax-exempt if the overall gain from taxable private sale transactions is less than € 600 in the year concerned (tax-exempt limit). However, it is not only the sale of bitcoins on an exchange for a sovereign currency that is relevant here for tax purposes but also, for example, exchanging bitcoins for other cryptocurrencies or their use as a means of payment. In such a case, the sale price would be the value of the goods or services received in return.

If the bitcoins were generated through mining by the seller and if these activities could (still) be assigned to the personal sphere then, according to a decree of the Hamburg tax authority from 11.12.2017, even during the speculation period this would not constitute a taxable private sale transaction because the requisite prior acquisition would be missing.

» **Please note:** Then again, according to a German government statement (Lower house of German parliament (Bundestag, BT) printed matter 19/370 from 5.1.2018), transaction fees that have been paid would however constitute taxable other income.

If the bitcoins were acquired on different dates and, thus, also at different price levels, then in the case of a sale during the speculation period, firstly, the question that arises is whether the sale still occurred during the speculation period if some of the acquisitions took place more than 12 months ago and others over the course of this period. Secondly, in the case of the acquisition of bitcoins at different price levels, here there is the problem of how to determine the acquisition costs that have to be matched against the sale price. In the view of the tax authorities, in line with the legally prescribed "chronological order of sales" for foreign currency amounts, the so-called FIFO (first in first out) method should generally apply here. This means that the bitcoins that were acquired first should be deemed to have been sold first. It would be possible to take an approach other than the FIFO method because, technically, each bitcoin in the blockchain could be identified. This is because if the bitcoins are kept in different accounts or "wallets" (electronic purses) then, to this extent, it is possible to clearly identify the time and cost of each acquisition.

3. Taxation in the business sphere

If the bitcoins are allocated to business assets, or if a bitcoin mining operation is "professionally" run, then the income from the bitcoin trading has to be taxed as income from business activities.

In this case, bitcoins, as intangible assets for business purposes, will be subject to the general accounting and taxation rules. Gains and losses arising from the trading and mining of bitcoins would thus be subject to taxation. The accounting treatment will depend on whether, in a specific case, the bitcoins should be allocated to fixed or current assets. Here, under German commercial law and tax law, this would then give rise to the following legal consequences (some examples):

- prohibition on recognition for tax purposes in the case of self-created bitcoins (mining) if these have to be allocated to fixed assets.
- Under German commercial law there is a requirement to write down bitcoins held as current assets if, on the balance sheet date, the price has fallen below the acquisition costs.
- On the basis of the accounting principle of single unit valuation, the bitcoins would generally have to be recognised separately at their respective cost of acquisition or production. According to the wording of the law, the application of consumption sequence procedures, such as the LIFO (last in first out) method, FIFO or an average valuation would only be possible if the bitcoins were included in the inventories.

If, over a period, losses have been generated on balance then there would be a risk that the tax authority would attribute these losses to Liebhaberei (a German tax term that refers to a situation where the taxpayer performs an activity without the intention to realise (taxable) profits) and would not recognise them. In view of the high level of initial investment that is required, if there were potential falls in the bitcoin price then this scenario would not be improbable.

4. Value Added Tax

If the sole purpose of cryptocurrencies, such as bitcoin, is to use them purely as a means of payment then, from a VAT perspective, the use of bitcoins is then placed on an equal footing with the use of conventional means of payment. Thus, paying with bitcoins would not be taxable. Acquiring and selling bitcoins against Euros does indeed constitute taxable other services, however, according to Section 4 no. 8 of the German VAT Act (Umsatzsteuergesetz, UStG) (financial services) these are deemed to be tax-exempt (cf. BMF circular from 27.2.2018).

» **Please note:** Purchasing and selling other cryptocurrencies against Euros is tax-exempt, too, if this cryptocurrency ...

- has been accepted by the parties involved in the transaction as an alternative contractual and direct means of payment and
- it has no other purpose than to be used as a means of payment.

The BMF is currently of the view that, from a VAT perspective, the miners' services do not constitute taxable events as the transaction fees are paid voluntarily and, therefore, there is no direct connection to the miners' services. Moreover, compensation in the form of new bitcoins through the system itself cannot be regarded as a consideration because the exchange of services necessarily requires an identifiable recipient.

» **Please note:** The VAT treatment of mining is currently still being discussed at the EU level.

StB [German tax consultant] Steffen Heft, StB [German tax consultant] Tim Guschl, Heidelberg

TAX

The tax policy objectives of the new German government – Who will enjoy tax relief?

The CDU/CSU and SPD reached a coalition agreement on 7.2.2018. Besides a balanced budget with no new debt and a reduction in the debt-to-GDP ratio, the agreement pursues wide-ranging tax policy objectives. In the following section we have provided an overview of the main tax changes so that you will have an idea of who can expect to enjoy tax relief, or at least simplifications, and who should anticipate burdens.

1. Business taxation

(1) Concessions – There are plans to provide tax relief, in particular, for young and innovative companies. Firstly, one aim is to give tax breaks to small and medium-sized research enterprises to facilitate their research and, secondly, to create incentives to assist business start-ups by simplifying the procedures relating to the application, approval and taxation of these. E-mobility will be promoted via special depreciation of 50%, which will be available in the year of purchase for electric vehicles used for commercial purposes, although this concession will be limited to a period of five years.

(2) International tax law – EU initiatives, already under way, concerning fairer taxation of large groups as well as for the introduction of a common assessment base and minimum rates for corporate taxes will continue to be supported in the future; there will be an aggressive strategy of clamping down on tax evasion and tax avoidance. The government will seek to have the OECD BEPS requirements implemented on a worldwide basis in order to create the conditions for fair tax competition for cross-border business activities. In Germany this includes, among other things, up-to-date arrangements for the taxation of CFC income and adjustments to the interest barrier.

(3) Sales tax and Real Estate Transfer Tax – The German government sees a need for action and improvement as regards preventing fraud and circumvention structures particularly in the case of sales tax and Real Estate Transfer Tax (RETT). For example, the procedures for imposing and refunding import sales tax will be optimised with a view to eliminating competitive disadvantages for German industrial and commercial enterprises as well as airports and seaports. Following the completion of a review of RETT provisions by a joint working group of the German federal and state governments there are now plans for more effective statutory provisions, which would also provide greater legal certainty, in order to counter harmful tax practices through share deals.

2. Personal taxation

(1) Tax relief – The tax burden will not be increased and, at the same time, the incremental abolition of the solidarity surcharge should bring about tax relief from 2021. As a first step, lower and middle incomes will enjoy relief through the introduction of a tax-exempt limit (with a sliding scale). In this way, around 90% of taxpayers will be completely exempted from the solidarity surcharge. Moreover, a report on the developments of so-called "cold progression" tax increases (which arise from the fact that Germany does not adjust tax brackets for inflation) will continue to be produced every two years and the income tax brackets will be adjusted accordingly.

Housing campaign for families with children

(2) Property and family – Within the scope of a so-called housing campaign, there are plans to allow special depreciation of 5% per year in addition to the straight-line depreciation for new residential construction and energy-efficient modernisation of buildings. Furthermore, the government will consider the introduction of a RETT tax-free threshold for first time purchases of residential property by families. Moreover, families will also receive support through increases in child benefit and tax exemptions for dependent children.

(3) Real estate tax – Real estate tax, which is an important source of revenue for municipalities, will be put on a solid basis first of all and a real estate tax "C" will be introduced in order to progress the release of building land for residential purposes.

(4) Investment income – Withholding tax on interest income will be abolished. If an individual's personal tax rate is above 25% then s/he should expect a significant increase in his/her tax on investment income. The new German government is sticking to its goal of introducing a financial transaction tax at the European level.

3. Cutting red tape

There will be fewer requirements for companies to report statistical data and an easing of European reporting requirements (in this case for SMEs with fewer than 500 employees) will be introduced. There are plans for: the standardisation of limits and thresholds in different areas of legislation, the digitisation of administration, the harmonisation of, for example, provisions under German commercial law and tax law as well as for timely tax audits.

There will also be a boost in the cutting of red tape for ordinary citizens. In the course of this, electronic communications with the tax authorities will be expanded and the aim is to introduce prefilled tax returns for all taxpayers by the time of the 2021 assessment period.

Conclusion – The new German government's plans are ambitious and should result in tax relief for many taxpayers. In contrast to this, the abolition of withholding tax on interest will however lead to a significant tax increase for many savers. It remains questionable whether precisely the incremental abolition of the solidarity surcharge as well as the planned subsidies for research activities and for the creation of housing will not, after all, initially stretch the federal government budget to its limits. At any rate, the plans for cutting red tape and the digitisation of bureaucratic processes should generally be welcomed. However, the implementation will have to demonstrate how effective the individual measures are.

» **More Information:** The coalition agreement is available at www.bundesregierung.de (German version only).

WP/StB [German public auditor/ tax consultant] Dr. Matthias Heinrich, Würzburg

Legal advice connected to land and property – Be mindful of the VAT consequences

» **Who for:** Companies who issue or receive invoices for legal advice connected to land and property.

» **Issue:** In its circular from 5.12.2017, the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) made revisions to its guidelines for gauging if legal services should be regarded as other services connected to land and property. Moreover, the BMF amended Section 3a.3(7) of the VAT Application Decree (Umsatzsteueranwednungserlass, UStAE) accordingly. Generally, the new rules require legal services to be treated as land and property services if they are connected to the transfer of specific land and properties, or the creation or transfer of specific rights (e.g. rental/leasing rights) to land and property. In another circular, from 13.2.2018, the BMF has now clarified that no complaints shall be made if the previous guidelines - where only the typical notary services were regarded as land and property services - are still used in respect of legal services provided up to 31.12.2016.

The new rules are significant because land and property services always have to be taxed where the land and property

are located and not where the supplying company or (in the case of B2B) the recipient of the service operates its own business. Therefore, for example, a purchase agreement negotiation by a lawyer in connection with land and property in Germany would then also be subject to VAT there if these services were provided to a foreign business owner. Only if the service had been provided prior to 1.1.2017 could it still be treated as a service unrelated to land and property and, consequently, taxed there where the recipient of the service operates its own business abroad.

» Please note: The difference between legal services related to land and property and such services unrelated to land and property emerges from the instructive examples in Section 3a.3(9) no. 9 and (10) no. 7 of the UStAE.

StB [German tax consultant]
Marco Herrmann, Cologne

LEGAL

Works council elections in 2018 – Basic rules for the proper procedure

In accordance with the Works Council Constitution Act (Betriebsverfassungsgesetz, BetrVG), elections loom in 2018 for companies which have works councils. In the following overview we discuss the most important legal issues that you need to take into account so that these elections are able to take place as they should.

1. Timing and conducting

The works council should be elected every four years in the period from1 March until the 31 May. An election committee has to be appointed by the previous works council in order to conduct a secret and direct election. Elections should generally be conducted during working hours. The works council is elected in accordance with the principles of proportional representation (a so-called election by list). Here the electors vote for a predetermined list. If only one list is available, or if the company has fewer than 50 members of staff then the employees vote directly for candidates in accordance with the principles of majority elections (personalised voting).

In 2018 it will be time to queue up at the company ballot box.

2. An employer's enterprise and the size of the works council

One works council is elected for each enterprise. According to the BetrVG, an enterprise is an organisational unit within which an employer pursues specific operational purposes and which usually employs at least five permanent members of staff who are entitled to vote, of which three will be eligible to stand for election. If a part of the enterprise has a minimum level of organisational independence in relation to the main operation then it too can constitute an enterprise. Delimitation issues can be clarified at status proceedings in court (Section 18(2) BetrVG).

The number of works council members that are to be elected will be based on the number of employees who are entitled to vote. These also include temporary workers as soon as they have been deployed in the enterprise for more than three months.

3. General obligations of employers

The employer shall bear the costs of the works council elections. These include, in particular:

- costs for materials and personnel in connection with the elections,
- the obligation to continue paying remuneration to employees when they are absent from work during the elections or on election committee business,
- the costs of engaging legal consultants as required.

The employer shall supply to the election committee the first name and last name, date of birth, gender and date of joining the company of all members of staff employed by the business.

4. Protection against dismissal

Works council members qualify for special protection against dismissal during their term of office and for up to one year afterwards. In this way, normally, statutory notice of termination is inadmissible. Nevertheless, extraordinary notice of termination for good cause is still possible with the approval of the works council. In principle, members of the election committee, election candidates and (to a limited extent) the "initiators" of elections, likewise, qualify for special protection against dismissal.

RAin [German lawyer]
Maha Steinfeld, Duisburg

Remuneration increases subsequent to the transfer of an undertaking – Caution is required with respect to dynamic reference clauses

» **Who for:** Business sellers and buyers.

» **Issue:** It is not uncommon for transfers of undertakings to be carried out against the background of the aim of achieving cost savings through the affected employees ceasing to be covered by a collective agreement and/or becoming subject to different remuneration arrangements. Section 613a of the German Civil Code does indeed specify that, in the event of a transfer of an undertaking, the legal provisions of a collective agreement or a works agreement become part of the employment contract between the new owner and the employee and may not be changed to the disadvantage of the employee before the end of the year after the date of transfer. However, employees would no longer be entitled to future wage and salary increases in accordance with collective agreements.

However, the situation changes if the collective agreement is not directly applicable but, instead, on the basis of a so-called dynamic reference clause in the employment contract (e.g.: " ... the collective agreement xyz as amended shall apply"). The new employer is then obliged without any time limits to implement future wage and salary increases in accordance with collective agreements even though the employer itself has no possibility to exert any influence on the collective agreement. This is also consistent with EU law, as the ECJ ruled in April 2017 having taken a different view in 2013. The unrestricted continued validity of dynamic reference clauses even applies if the transfer of an undertaking includes switching from ecclesiastical labour law to labour law in private law - according to the Federal Labour Court (Bundesarbeitsgericht, BAG) as stated in two recent rulings from 23.11.2017 (case references: 6 AZR 684/16 and 683/16). The employees of a rescue service operated by the Lutheran Church in Germany were passed on to a secular buyer. However, as the applicability of the employment contract regulations, as amended, of the Diakonisches Werk (German Lutheran Church's welfare and social work organisation) had been agreed in the employment contracts of these employees they were also able to demand that their new employer should continue to implement the wage and salary increases in accordance with these regulations.

» **Recommendation:** Prior to acquiring a business we would advise buyers to carefully scrutinise the existing employment contracts in order to avoid surprises accordingly.

RA/StB [German lawyer/tax consultant]
Frank Moormann, Braunschweig

A non-compete clause can be revoked via a notice of repudiation of contract

» **Who for:** Employers and employees who agree non-compete clauses.

» **Issue:** Employers frequently agree with executives on so-called post--contractual non-compete clauses. These regulate that after the termination of the employment relationship the employee may not engage in competitive activity for a specific period and will receive compensation for adhering to this. A contractual non-compete clause is generally binding for both parties.

The Federal Court of Justice (Bundesgerichtshof, BGH) recently ruled on a case (ruling from 31.1.2018 – 10 AZR 392/17) where its judges confirmed the ruling by the court of first instance and dismissed the appeal of an employee against his employer for the payment of contractually agreed compensation for adhering to a non-compete covenant. The employer had initially not paid the agreed compensation to the employee. After the employee's payment request to the employer failed to yield any results, in an e-mail to the employer the employee declared that he no longer felt bound by the non-compete clause. During the proceedings he had argued that his declaration had been merely an act of defiance.

By contrast, the BAG regarded his declaration as a permissible and effective repudiation by the employee of the non-compete clause, which could be judged to be a reciprocal contract. According to the statutory provisions in respect of revocation in Section 232ff. of the German Civil Code, a contractual partner shall be released from its obligation to perform if the other contractual partner does not perform its service. According to the judges, on account of the non-payment of the compensation by the employer the employee had been entitled to revoke the clause and had effectively declared this via e-mail. Therefore, once the notice of repudiation of contract had been received the reciprocal contractual obligations no longer applied.

Outcome: The employee was thus no longer bound by the non-compete clause and, at the same time, once the notice of repudiation of contract had been received the employer was, however, released from the obligation to pay compensation.

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ACCOUNTING & FINANCE

Company valuations for inheritance tax purposes – Deferred taxes should not taken into account when calculating the net asset value

» **Who for:** Private individuals with shareholdings in corporations.

» **Issue:** Shareholdings in corporations have to be recorded at their fair market value for inheritance/gift tax purposes. However, this value may not fall below the net asset value - consisting of the sum of the company's business assets and liabilities - embodied in the shareholdings. The Federal Fiscal Court (Bundesfinanzhof, BFH), in its ruling from 27.9.2017 decided that, when calculating this net asset value, taking into account the income tax charge that would arise as a result of a liquidation that is merely planned cannot be considered to be relevant. This is because in the absence of a liquidation resolution the tax liabilities will not have yet legally arisen and so impairment in value through the recognition of a provision or a liability in the tax accounts would be precluded. Furthermore, neither the shareholder's actual remaining disposal gain (minus any tax charges) could be considered to be relevant as a benchmark for the valuation of shareholdings in corporations nor would there be any concerns in terms of compatibility with constitutional law as regards the gradual double taxation that would be tolerated as a consequence.

» **Recommendation:** In the (reverse) case of hidden encumbrances no (deferred) claims for tax refunds could thus be incorporated into the net asset value either. Moreover, based on this ruling, companies that are already in liquidation can now potentially argue that, from now on, only the previous deferred tax liabilities can be taken into account.

Please note: The legal situation is unsystematic in this respect given that if the income capitalisation method is used then a notional tax rate approximated at 30% also has to be applied, which reduces the profit, even if there are tax loss carry-forwards.

» **More Information:** The BFH ruling from 27.9.2017 (case reference: II R 15/15) is available at www.bundesfinanzhof.de (German version only).

StBin [German tax consultant] Isabee Falkenburg, WP/StB [German public auditor/ tax consultant] Dr. Dietrich Jacob, Hamburg

AND FINALLY…

„Intelligence is the ability to adapt to change."

Steven Hawking, , British physicist and astrophysicist, 8.1.1942 – 14.3.2018.

Impressum

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