PKF

Accountants &
business advisers

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Editorial

Dear Readers,

In the future, it will indeed be possible to carry out **intragroup restructurings without triggering real estate transfer tax** after all. At any rate, that is the opinion of the ECJ's Advocate General. In the Focus section you can read about the case, the developments in court and the Advocate General's explanatory statement as to why this tax exemption does not constitute state aid.

In the Tax section, we conclude our **series of articles on the PKF model for a Tax CMS**. We describe practical examples for measures for guidance and monitoring that are implemented in Phase III of the VAT Module in order to reduce the risks in the processes. Moreover, in the subsequent contributions you can read how the **ECJ** is showing the German tax authorities where the limits are with respect to the **adding back** of supposed benefits for foreign group companies and by refusing an **input tax deduction in the case of prepayments**. We have also provided a little tax tip for spouses.

In the Legal section, the first article is concerned with the application of a statutory provision for the shareholders of a GmbH (German limited company) to limited partners that in certain – but not insignificant – cases can lead to the exclusion of voting rights. You can then read a report about a General Federal Labour Court ruling that strengthens the rights of employees who (have to) **go to the doctor during working hours**. We round off our legal section with a report on legislative amendments with respect to **data protection** and **disclosure requirements**.

In the Accounting & Finance section, we have reviewed for you a series of important rulings on **tax law governing German accounting treatment.** In both the articles on the subject of provisions it is surprising that it is not the economic cause that should constitute the determinant of **whether or not a provision may be created** but rather – although in no way more obvious – a particular point in time. Risks are frequently associated with the process of recognising **profit and loss transfer agreements** for tax purposes and in our final article there is a review for you of the most important key points with respect to the start, structure and scope of these agreements.

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

Your PKF Team

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FOCUS

Real estate transfer tax in the case of a merger has not been deemed to be state aid after all

According to Section 6a of the Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz, GrEStG*), for specific intragroup restructurings real estate transfer tax (*RETT*) does not have to be paid. Yet, restructurings or pending arrangements were most recently subject to the risk that the EU Commission might come to view that the rule under Section 6a GrEStG provides an illegal subsidy and this rule could thus have been prohibited. However, it should now be assumed that the ECJ judgement will be favourable for businesses because in the conclusions of the Advocate General, which were presented on 19.9.2018, Section 6a was not deemed to constitute aid

1. The rule – Exemption under Section 6a GrEStG

RETT generally covers all changes to the legal arrangements for a property located in Germany. According to Section 1(1) no. 1 et seq. of the Reorganisation Act (Umwandlungsgesetz, UmwG) (which covers mergers, demergers and asset transfers), in principle, reorganisations are also subject to RETT. In the case of specific intragroup restructurings, according to Section 6a clause 1 GrEStG, RETT does not have to be paid. In particular, there is a tax exemption for reorganisations where only one controlling company and one or more enterprises that are dependent on this controlling company are involved. An enterprise is deemed to be dependent if for five years prior to and five years following a legal transaction the controlling company continuously owned, directly or indirectly, at least 95% of the enterprise's capital (Section 6a clause 4 GrEStG). Section 6a is also referred to as the corporate group clause.

The Federal Fiscal Court's order for reference from 30.5.2017

The Federal Fiscal Court (*Bundesfinanzhof, BFH*) dealt with a case where a 100% subsidiary, which owned several properties, was merged with its parent company. The parent company had held the shares in the subsidiary for more than five years. The BFH, on 25.11.2015 (case reference: II R 62/14), ruled in favour of an exemption in the case of an upstream merger and thus against the opinion of the tax authorities (identical decrees of the federal states from 19.6.2012, published in the German Federal Tax Gazette (Bundessteuerblatt, BStBl) I p. 662). In the opinion of the BFH, a subsequent holding period of five years is only applicable to the extent that it can be complied with in the wake of a reorganisation. However, a shareholding ceases to exist after a merger so that no time limit can be imposed. The tax exemption should thus be granted. In this respect, the BFH disagreed with the tax authority that had refused to grant a tax concession due to non-compliance with the subsequent holding period requirement. Furthermore, the BFH has asked the Federal Ministry of Finance (*Bundesministerium der Finanzen, BMF*) to intervene in the case in connection with the preconditions for a tax exemption under Section 6a GrEStG. In its ruling from 30.5.2017, the BFH then referred the case to the ECJ over the issue of whether or not the corporate group clause under Section 6a GrEStG is compatible with the EU's prohibition on aid as enshrined in Article 107 et seq. of the TFEU (Treaty on the Functioning of the European Union) (BStBl II 2017 p. 916).

It will still be possible to merge companies within a corporate group on a tax-exempt basis

3. The tendency is not to view this as state aid

The oral hearing before the Grand Chamber of the ECJ in the case C-374/17 took place on 11.6.2018. At this hearing there was already a discernible tendency that the ECJ was unlikely to view Section 6a GrEStG as a violation of the state aid prohibition. Moreover, the Advocate General has now presented his conclusions (on 19.9.208). According to these, the tax exemption under Section 6a GrEStG does not constitute state aid but is rather an innocuous general measure as it is available to every German and foreign enterprise that owns property in Germany.

Recommendation: The judgement of the ECJ remains to be seen. Although, the ECJ is likely to follow the conclusions of the Danish Advocate General. Legal certainty would then prevail once again to the effect that specific intra-group restructurings would not trigger any RETT.

StBin [German tax consultant] Sabine Rössler/ WP/StB [German public auditor/ tax consultant] Daniel Scheffbuch

TAX

Tax Compliance Management Systems – Part E: Measures for guidance and monitoring using the example of VAT (Phase III of the PKF Model)

In the last two issues of the PKF Newsletter we discussed risk analysis (Phase II). Firstly, in Part C of our series, we described how to conceptualise the documentation of processes as well as the identification of existing measures and the evaluation of risks for the Module on the (German) Principles of Proper Keeping and Retention of Accounts, Records and Documents in Electronic Form as well as Access to Data (*GoBD*). Subsequently, in Part D, we provided assessments with respect to the extent of loss and occurrence probabilities for practical examples of risks selected from the "payroll tax/social security" module. What now follows here, in Phase III, is the development and implementation of measures for guidance and monitoring on the basis of the tax risks identified in Phase II. Specifically, in the section that follows, we describe for the VAT Module how risks can be reduced in a targeted way and compliance violations can be prevented.

1. Legal requirements and VAT

Within the scope of VAT, erroneous incoming invoices constitute significant risks. A proper invoice has to include certain minimal constitutive elements. This information should be checked by the recipients of invoices if they wish to safeguard their input tax credits. In addition, taxpayers have to fulfil other obligations, such as the proper and timely filing of advance VAT returns and annual declarations. Advance VAT returns should generally be submitted to the tax authority by the 10th calendar day of the submission period and the annual declaration, if it is prepared by a tax consultant, by the 31.12. of the following year after the end of the assessment period.

Besides these general obligations, there are other requirements depending on the business model.

- Business owners who export supplies abroad have to document this accordingly with evidence in the form of accounting records and receipts.
- In the case of supplies to foreign countries within the EU, recapitulative statements have to be filed with the German Federal Central Tax Office on a regular basis.
- When certain sales thresholds for imports and exports are exceeded then Intrastat returns have to be submitted.
- For the respective transactions, attention should be paid to the rules on the reversal of the liability for the payment of VAT in the case of services provided to companies in foreign countries within the EU as well as the rules on intra-Community triangular transactions and consignment warehouses.

» **Please note:** If advance VAT returns are submitted late then the local tax office can impose a surcharge for late filing. If an advance payment is filed but the tax is not actually paid then there is a risk of penalties for late payment as well as of fines. If the taxpayer does not file an advance return or provides false information then this could be viewed as tax avoidance and would result in criminal proceedings.

2. Tax Compliance Programme

2.1 Prerequisites for the implementation

It is crucial for the success of a compliance programme that the staff in the tax department as well as those from departments with areas of responsi-

bility that are relevant to VAT have the requisite knowledge about VAT. The processes for complying with statutory requirements should be documented and should include controls that already exist. In the course of this, the adjacent operating divisions (such as logistics or sales) should also be integrated. It should be ensured that the responsible staff members have adequate knowledge in the field of taxation in order to be able to identify potential risks and communicate them. The tax department should receive adequate staffing in order to counter the risk of not being able to perform elementary tasks, such as filing advance tax returns and annual declarations within the stipulated periods.

2.2 Measures for guidance and monitoring

The following measures for guidance and monitoring lend themselves in particular to ensuring that VAT obligations are fulfilled.

- Regular training for staff with functions that are relevant to VAT
- The implementation of a "4-eyes principle" for exceptional VAT cases
- Quality checks of VAT data records and reports (possibly also with the help of data analysis programs; e.g. VAT View)
- Regular updates of the automated VAT processes in the IT systems

2.3 Compliance monitoring and improvements

Within the scope of VAT, the appropriateness and effectiveness of a system can be monitored with the help of the following measures in particular.

- Reviews of the processing of VAT data in the ERP
- Regular updates of the master data
- Reviews of the overall transaction data with respect to risks
- Monitoring of the carrying out of and participation in training
- Checks of the controls for tax returns and tax declarations
- Reviews of procedural instructions

3. Tax Compliance Communication

It is crucial for the success of a Tax CMS to pre-define clear communication channels as well as the roles and responsibilities of each staff member for his/her scope of functions. A process has to be determined for reporting tax compliance risks as well as information on potential or established rule violations to the appropriate departments in the company. Communication can take place, e.g., in the form of letters to the staff, compliance manuals or training sessions. Here, the following aspects are of particular importance:

- periodic compliance reporting to the company's management
- communication with the tax authorities
- information for staff about amendments pertaining to VAT
- communication about new or modified processes that are relevant for VAT
- providing to the accounts department information that is required for the annual financial statements

Quality checks for VAT data records and reports

4. Conclusion

Within the scope of a Tax CMS a special focus should be placed on the sphere of VAT because the tax authorities usually ascribe a great deal of importance to this area in tax audits. For the tax authorities, a functioning VAT compliance system can be viewed as an indication that any actions have not been wilful or negligent.

WP / StB [German public auditor / tax consultant] Jens Düe / StB [Tax consultant] Enrico Kiehne

ECJ calls for an opportunity to present evidence within the context of Section 1 of Germany's Foreign Transaction Tax Act

» **For who:** German companies that provide services for no consideration to foreign group companies.

» **Issue:** In purely domestic (German) cases, services that are provided to associated companies for no consideration do not have any tax repercussions because these are not contributable transfers of rights to use and benefit. However, in the case of cross-border transactions, Section 1 of the Foreign Transaction Tax Act (*Außensteuergesetz, AStG*) leads to a correction if domestic income is reduced because conditions have been agreed that do not comply with the arm's length principle.

A German joint stock company (*Aktiengesellschaft, AG*) had provided so-called comfort letters for the benefit of Dutch group companies with overextended balance sheets without asking for separate remuneration for this. The financing bank had made the continuation of loans for the group companies contingent on the provision of comfort letters. Subsequently, the local tax office in Germany had made a correction to the income pursuant to Section 1 AStG. The AG had initially appealed against this and then it initiated a legal action. The tax court then referred the issue of whether or not Section 1 AStG is compatible with EU law to the ECJ.

In its judgement from 31.5.2018, the ECJ explained that Section 1 AStG is only compatible with EU law if the provision provides an opportunity for the taxpayer to present evidence of a commercial justification for a transaction concluded on non-arm's-length terms where that justification arises from the taxpayers position as a shareholder. In the case in question, the ECJ was of the opinion that the AG had its own financial interest in the foreign group company's commercial success in which it ultimately participates in the form of dividends. By taking into consideration, for the first time, the position of the shareholder as an important reason for arrangements that deviate from the arm's length principle, the ECJ has accordingly thrown the door wide open for discussions with the tax authorities. If comfort letters for no consideration can be justified then this should also apply to, e.g., interest-free or low-interest loans. While the judgement relates to Section 1 AStG in the version from 2003, nevertheless, it is also likely to have repercussions for the provisions that were subsequently included in this act that relate to the transfer of functions and the calculation of profits for permanent establishments. This is because both provisions lack opportunities to present evidence of commercial reasons for deviating from the arm's length principle.

» **Recommendation:** For tax audits that are already under way, appeal processes, etc., it would thus be advisable to keep these open by making reference to the ECJ judgement or to use the arguments provided by the ECJ.

» **More Information:** The opportunity to present evidence that the ECJ has called for is not provided for in Section 1 AStG. It thus remains to be seen whether, in the course of the proceedings, the tax court will completely reject Section 1 AStG, or if by way of interpretation it will "smuggle" the opportunity to present evidence into the provision. You can look up the ruling under case reference C-382/16 on the ECJ website (http://curia.europa.eu/juris/).

StB [German tax consultant]
Thorsten Haake

ECJ view on input tax deduction in the case of prepayments where supply is not performed

» **Who for:** Businesses with a right to deduct input tax that have made prepayments for supplies that were not performed.

» **Issue:** The Federal Fiscal Court (*Bundesfinanzhof, BFH*) referred to the ECJ the issue of how to deal with input tax deductions by a goods recipient if the supplier does not fulfil its delivery obligation and the goods recipient has already mad a prepayment. The BFH was of the view that the input tax could not be deducted because at the time of payment the supply was not certain. The ECJ did not accept this argument and clarified that a taxpayer cannot be denied an input tax deduction if s/he did not know or could not have known that the supplier did not intend to fulfil the delivery contract. In addition, correcting the input tax deduction when the prepayment is reimbursed conforms with the EU regulations in Articles 184 to 186 of the Directive on the VAT System. When the prepayment is reimbursed the input tax thus has to be corrected.

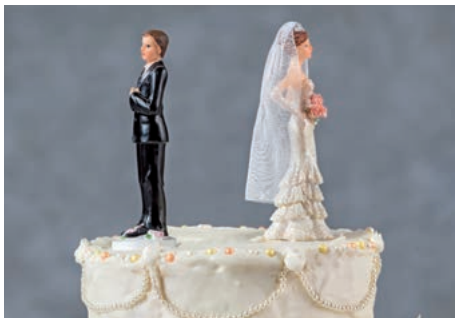
» **Recommendation:** In any event, you should check the rights to deduct input tax.

WPin/StBin [German public auditor / tax consultant] Christina Thiel

Individual tax assessment for spouses and their special expense deductions

» **Who for:** Married taxpayers with an application for a 50% apportionment in the case of an individual tax assessment.

» **Issue:** If spouses wish to split special expenses, extraordinary burdens and tax reliefs pursuant to Section 35a of the German Income Tax Act (*Einkommensteuergesetz, EStG*) by way of derogation from the real economic burdens of both spouses then they have to file a joint application in this regard. However, because of a decision by the Baden-Wuerttemberg tax court (ruling from 29.11.2017, case reference 2 K 1032/16), currently, there is legal uncertainty with respect to this issue. The Baden-Wuerttemberg tax court was of the view – contrary to common practice – that, first of all, the overall expenses incurred should be added together and



subsequently split in half. In the course of reaching its decision here, the court based its arguments on the fact that, with respect to the provision in Section 26a(2) clause 2 EStG, the intention of the legislator had been tax simplification and this presupposes that, first of all, the expenses should be allocated equally between the spouses. Furthermore, the wording of the provision was the reason given by the tax court for its decision.

» **Recommendation:** The advantage of the decision by the tax court is that the spouses neither have to prove nor the local tax office has to check which spouse economically bore the costs and to what amount. However, you will have to bear in mind that the decision of a tax court does not always lead to a more favourable result. You should thus carefully examine whether or not an application for a 50% apportionment for individual tax assessment for spouses would be advantageous. In applicable cases, in view of the pending appeal proceedings at the Federal Fiscal Court, in respect of case reference III R 11/18, you could lodge an objection.

WPin/StBin [German public auditor / tax consultant] Christina Thiel

LEGAL

Voting prohibitions for limited partners

» **Who for:** Limited partners.

» **Issue:** The Commercial Code (*Handelsgesetzbuch*, HGB) does not contain any provisions on the exclusion of limited partners from the passing of resolutions at general meetings to approve contracts between a company and its limited partners. Whether or not a provision in the German Limited Liability Companies Act (*GmbH-Gesetz, GmbHG*) (Section 47(4) clause 2 GmbHG) should be applied in such cases is contentious and has not yet been decided by the German Supreme Court.

Recently, in a ruling from 18.7.2018, the Munich court of appeals (*Oberlandesgericht, OLG*) argued in favour of applying the provision accordingly (case reference: 7 U 4225/17). The reason provided for the application of the exclusion of voting rights at a German limited partnership (*Kommanditgesellschaft, KG*) was that the provision in GmbH law flows from a general principle. When it comes to voting, you cannot expect that those who have their own stakes in the business will subordinate their own needs to those of the business. That is why an analogous application for a KG is justified. Moreover, the OLG has extended the scope of the application of the exclusion of voting rights to the effect that the prohibition on voting also applies to cases if the respective contract is not being concluded between the KG and a limited partner but, instead, between the company and a subsidiary company of a limited partner. The facts of the case that formed the basis of this ruling were that a property owned by a KG was supposed to be sold to a subsidiary company of the limited partner. At the general meeting of the KG, the limited partner participated in the passing of the resolution on the sale of the property. The OLG ruled that the limited partner's vote was a violation of Section 47(4) clause 2 GmbHG. Voting rights are excluded if the shareholder has such strong commercial links to the company's contracting party that the shareholder's personal interest can be equated with that of the contractual party. This applies if the shareholder has a strong own commercial interest in the contract and there would be support for this view if the shareholder had a majority shareholding in the contracting party.

» **Recommendation:** Due regard should be give to the prohibition on voting pursuant to Section 47(4) clause 2 GmbHG in the case of a KG, too. Potentially, this could also be applicable if the shareholder him/herself is not the KG's contracting party.

RA/StB [German lawyer/tax consultant] Christian Wilke

Attending doctor appointments during working hours

» **Who for:** Employers and employees covered and not covered by a collective agreement.

» **Issue:** The case in question was about the issue of whether or not an employee could claim paid leave from his employer for the duration of a doctor appointment. The employee making the claim had attended the appointment during working hours because the doctor's surgery opening hours did not permit the employee to do otherwise. Subsequently, the employer refused continuing remuneration by recording the period of the appointment with the doctor as minus hours in the working time account.

After the labour court of first instance also rejected the claim for the continued payment of remuneration for the period of the doctor appointment, the claim was approved by the state labour court *(Landesarbeitsgericht, LAG)* of Lower Saxony. In the case in question, the claim arose from the applicable collective agreement (Section 14(3) of the framework agreement on general working and employment conditions for the wholesale and foreign trade sector in Lower Saxony). Here, the LAG made reference to the Supreme Court principles of the Federal Labour Court *(Bundesarbeitsgericht, BAG)* with respect to the obligation to continue paying remuneration for doctor appointments during working hours. Under the law, such an obligation generally exists in cases of no-fault absenteeism (cf. section 616 of the German Civil Code *(Bürgerliches Gesetzbuch, BGB)*) if

Doctor appointments are necessary but do they count as work hours?

- the medical treatment is necessary and,
- furthermore, the employee makes an effort to avoid the absence.

Here, the BAG respects the principle of the free choice of doctor and does not require employees to switch to a doctor whose surgery times are compatible with working hours. However, you should bear in mind that the entitlement to continued remuneration with respect to no-fault absenteeism could be excluded by means of individual contracts, or restricted to particular cases, if there are no contradictory collective agreements. It is necessary to distinguish between this obligation to continue paying remuneration and an employer's obligation in the case of an employee's incapacity for work (Section 3 of the German Continued Payment of Wages and Salaries Act), which cannot be contractually waived.

» **Recommendation:** Employers may exclude the continuation of remuneration in employment contracts in certain cases provided for under the law if the cases are clear and there is no conflict with collective bargaining rules.

» **Please note:** The ruling of the LAG of Lower Saxony from 8.2.2018 (case reference: 7 Sa 256/17) is available online at www.rechtsprechung.niedersachsen.juris.de (German version only).

RAin [German lawyer] Maha Steinfeld

GDPR – Combating the misuse of cease and desist letters

» **Who for:** Companies and clubs.

» **Issue:** Following an interdepartmental conference on 11.9.2018, the Federal Ministry of Justice and Consumer Protection (*Bundesministerium der Justiz und für Verbraucherschutz, BMJV*) forwarded the draft bill on "strengthening free competition" to the Bundestag (lower house of German parliament). With this law, the BMJV is planning various measures to thwart the improper use of cease and desist letters – not only in the GDPR sphere of activity. For example, among other things, the requirements for legal standing are supposed to be raised and the financial incentives for cease and desist letters will be limited. This should be achieved by restricting the amount of the potential contractual penalties and, as a consequence thereof, capping the value that can be claimed. Furthermore, the concept of the so-called "variable place of jurisdiction" is supposed to be abolished – up to now, under this system it has been possible to have a legal case heard in a court that was far away from the place of residence of the affected party. Moreover, the draft provides for greater transparency and simplified ways to assert counterclaims. However, there are no plans to completely exclude cease and desist letters under competition law. Yet, until the German Act to Combat the Misuse of Cease and Desist Letters comes into force the status quo will remain.

» **Recommendation:** With the systematic implementation of the requirements of the GDPR and other regulations that are relevant for competition it will be possible to avoid the risk of the improper use of cease and desist letters and thus minimise the cost risks posed by legal disputes due to cease and desist letters.

RAin/StBin [German lawyer/ tax consultant] Dany Eidecker

Update on shareholders' lists

» **Who for:** Shareholders and managing directors of a GmbH.

» **Issue:** Last year, the legislator widened the information disclosure requirements for shareholders' lists (Section 40 of the German Limited Liability Companies Act *(GmbH-Gesetz, GmbHG)*). Further details were regulated through the so-called Shareholders' List Regulation, which came into force on 1.7.2018. In particular, this regulation prescribes the type of numbering, a (new) column for recording changes and the provision of the size of the shareholding in percent.

(1) Numbering – From now on, numbering should be sequential using whole Arabic numerals (no letters) and sorted by shareholdings or by shareholders. "Used" numbers may generally not be re-assigned (numbering continuity). There is only one exception – when a so-called cleaned-up list is prepared because the previous numbering has become too confusing, the shareholdings can be given new numbers and the necessary "linking" to the previous numbering can be done by providing the appropriate information in the column for recording changes.

(2) Column for recording changes – Recording information in this column is mandatory when new numbers are assigned while for other changes (e.g. share capital measures, transfer of shareholdings, shareholders' changes of names or changes of residence) this is optional.

(3) Size of the shareholding in percent – Since last year, it has been mandatory to provide this information, which may be rounded to one decimal place. In the shareholders' list, it is possible to present an overall shareholding of all the shareholders of more or less than 100% as well as to use the key word label "less than 1%" to indicate that the shareholding is very small. However, shareholdings may not be rounded to 0.0%, 25.0% or 50.0% as this would be contrary to the intended "transparency" in respect of the majority shareholdings in the company.

Recommendation: Shareholders' lists have to be kept up to date; this will not only fulfil a statutory requirement but will also be in the own interests of shareholders and managing directors. Once the list has been adapted to the new requirements you can however wait until the next change in circumstances that has to be disclosed. This is expressly permitted in the shareholders' list regulation.

More Information: The "Shareholders' List Regulation" *(Gesellschafterlistenverordnung – GesLV)* is available online at www.gesetze-im-internet.de/geslv/BJNR087000018.html (German version only).

RA [German lawyer]
Dr. Johannes Hochgürtel

ACCOUNTING & FINANCE

Expansion of the scope for acquisition-related production costs

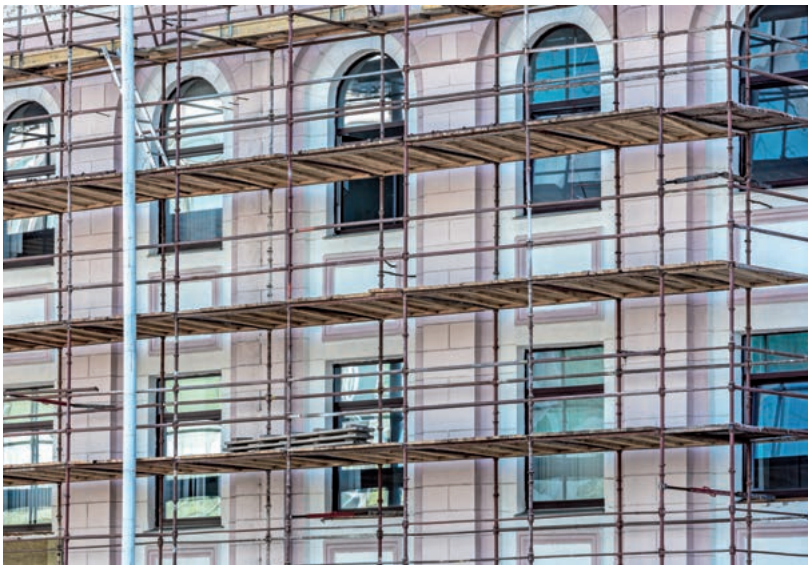
» **Who for:** Taxpayers who carry out maintenance and modernisation measures on buildings that have been acquired.

» **Issue:** General regulations under tax law specify that the expenses for maintenance and modernisation measures that are carried out within three years of acquiring a building and exceed 15% of the original acquisition costs will be recognised as acquisition-related production costs. Now, in a circular from 20.10.2017, on the basis of recent Federal Fiscal Court (Bundesfinanzhof, BFH) rulings, the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) has finally settled the treatment in the tax accounts for all cases that are still open. Acquisition-related production costs that have to be recognised are measured in terms of the amount and their time dimension as follows:

(1) For buildings that have been acquired since 1.1.2017, acquisition-related production costs include all costs for building measures that are incurred in connection with the maintenance and modernisation of a building that has been acquired. These include both the original cost for making the building ready for use by restoring parts of it that were unusable as well as the cost of substantial improvements to a building over and beyond its original state and also decorative repairs. In the case of decorative repairs, the relevant criterion of a close connection with the maintenance and modernisation measures in terms of space, time and substance is no longer applicable.

(**2)** If the building consists of several

units then the analysis of whether or not the costs for maintenance and modernisation measures give rise to acquisition-related production costs should be based on each stand-alone part of the building. It is not possible to make an assessment of the building overall if it is a mixed-use facility.



Are building refurbishment costs immediately deductible?

(3) All costs incurred for repairs, improvements and embellishments during a refurbishment within three years after the acquisition of the building should be taken into account when determining the measurement limit (15%) for acquisition-related production costs. This already applies retroactively for all buildings that have been acquired since 1.1.2017.

» **More Information:** The BMF circular from 20.10.2017 can be found at www.bundesfinanzministerium.de; it is a letter of implementation for the BFH rulings from 14.6.2016 (case references: IX R 25/14, IX R 15/15 and IX R 22/15).

WP [German public auditor]
Dieter Hanxleden

Accounting for advance commission payments and the expenses related to this

» **Who for:** Taxpayers who recognise agency services and costs in their accounts.

» **Issue:** Recently, the Federal Fiscal Court (Bundesfinanzhof, BFH), in its ruling from 26.4.2018 (case reference: III R 5/16) dealt with the recognition for tax purposes of advance commission payments. In the case in question, the Munich judges had to decide if an agent who prepares accounts has to report, as at the balance sheet date, business expenses made for travel services as "agency services in progress" if the commission income will only be realised in the subsequent fiscal year and is subject to the condition precedent that the service will have to be rendered. In comparable cases, there were circumstances in each instance where despite the fact that costs had been incurred (agency expenses) the contractors still had no claim for consideration due to the lack of an accrual. In the tax accounts, claims and liabilities arising from pending transactions may not be recognised for as long as it can be expected that the pending transaction will indeed be settled. This expectation that it will be settled is however no longer fulfilled once one of the contracting parties has fulfilled its obligations fully or partially while performance by the other contracting party is still outstanding.

If the expectation ceases to apply through a cash inflow then the transaction is treated as an advance payment that does not affect the operating result for tax purposes, or as a transitory prepaid item. The legal position is similarly unambiguous – once an obligation under the contract has been completely fulfilled and the remuneration claim has arisen. The revenue is thus recognised and this results in a receivable as a positive asset.

Under the established case law of the BFH, the term Wirtschaftsgut (asset) is broadly defined. It covers goods, rights or actual conditions, specific options or benefits for a business that

- a businessperson would be prepared to pay for to acquire,
- can be specifically measured,
- usually provides the use/benefit over many financial years and
- could at any rate be transferred together with the business.

Based on these principles of the case law of the BFH, in the case in question, the ongoing business expenses had not resulted in an asset being developed that could be recognised as "services in progress".

» **Decision:** As long as the commission claim of an agent who prepares accounts is still subject to the condition precedent that the transaction still has to be executed then the claim cannot be recognised as an asset. Advance commission payments should be recognised as a liability by the recipient under "advance payments received". Expenses that have an economic connection with advance commission payments should not be recognised as "services in progress" if no asset has been developed.

WP [German public auditor]
Dieter Hanxleden

The income tax treatment of liabilities in insolvency

» **Who for:** Companies facing insolvency proceedings

» **Issue:** The basic recognition and measurement rules under German commercial law and tax law should be applied without change in the course of insolvency proceedings. After the opening of insolvency proceedings, the question arises of if and when liabilities should be recognised at a value that differs from their nominal value, potentially a lower one. The adjusted value would then lead to a corresponding reporting of profit. In its established case law the BFH has ruled that liabilities may not (any longer) be recognised if they do not constitute an economic encumbrance. With a probability bordering on certainty, there is no such economic encumbrance if the debtor no longer has to expect that the creditor will make a claim (cf. BFH from 22.11.1988, case reference: VIII R 62/85). The mere fact that the debtor cannot repay the liability, or can only partially repay it due to a lack of sufficient assets still would not justify the assumption that there is no economic encumbrance (cf. BFH from 9.2.1993, case reference: VIII R 29/91).

The NRW regional tax office (*Oberfinanzdirektion, OFD*), moreover, updated its income tax summary (*Kurzinformation ESt*) no. 46/2014 from 21.11.2014 and determined that the cancellation of a debt during insolvency proceedings has an impact on profit. According to this, the reduction in the liability can then be taken into account via the income statement

- if a creditor effectively waives his/her loan receivable,
- if the cancellation of the loan receivables of subordinated creditors in the insolvency plan is confirmed by the court as being valid, or a release with respect to non-subordinated creditors is envisaged in the constructive part of the insolvency plan.

» **Recommendation:** After the opening of insolvency proceedings all companies would be well advised to explore a possible write-down of liabilities from the viewpoint of economic encumbrance and the tax consequences for the profit that arises.

WP [German public auditor]
Dieter Hanxleden / Andrea Rupper

Prohibition on provisions for investments that have to be capitalised but will no longer generate any income

» **Who for:** Businesses that create provisions for investments.

» **Issue:** A business used to dispose of waste, in return for payment, from disposal sites that it maintained. Furthermore, following the closure of the disposal sites the business was obliged to seal the surfaces and to treat or dispose of any toxic substances that leaked out at its own expense (Section 50(2) no. 1 of the Closed Substance Cycle Waste Management Act). An integral part of this obligation required the construction of facilities and operating equipment. During the period of the waste disposal operations already the operator of the disposal sites had created provisions for the investments needed for the fulfilment of its aftercare obligations.

In its ruling from 8.11.2016, the Federal Fiscal Court (*Bundesfinanzhof, BFH*) refused to permit the provisions to be recognised for tax purposes insofar as they were created for costs that would arise after the balance sheet date through the acquisition and construction of assets. The BFH based its interpretation on the wording of Section 5(4b) clause 1 of the German Income Tax Act. According to this, the prohibition on the recognition of such provisions covers expenses that, in future financial years, too, would have to be capitalised as the acquisition or production costs of an asset that would no longer be able to generate income.

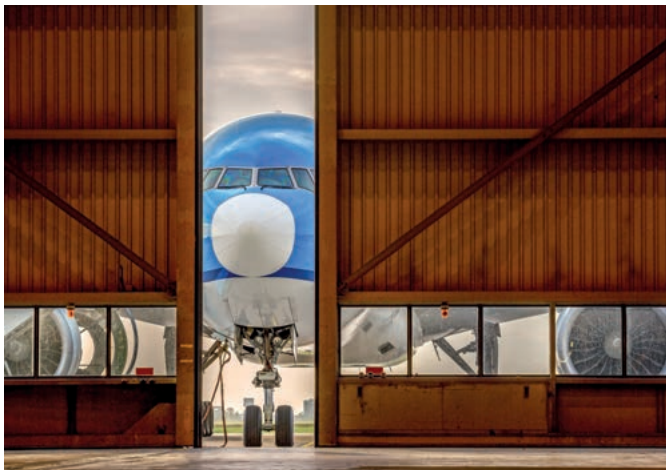
» **Please note:** With respect to the discounting of provisions for aftercare obligations, whether or not it will be necessary to create separate discounting periods for the so-called closure and aftercare phase will have to be assessed using the lawful grounds yet to be determined by the tax court for the respective aftercare obligations.

» **More Information:** The BFH ruling from 8.11.2016 was issued under case reference: I R 35/15 and can be found at www.bundesfinanzhof.de; the Münster tax court, as the court of first instance, made the decision in its ruling from 25.2.2015 (case reference: 9 K 147/11 K,G,F; cf. EFG 2015 *(Entscheidungen der Finanzgerichte*, or Tax Court Decisions) p. 1283).

WP Dieter Hanxleden / Andrea Rupper

After closure can provisions be created for the costs that have to be borne?

Requirements for provisions for future maintenance expenses



Provisions for maintenance work under scrutiny

» **Who for:** Businesses with a statutory obligation to carry out maintenance work after a predefined number of operating hours or within specified time periods to ensure operating safety for future use.

» **Issue:** The keeper of an aircraft or someone who leases (hereinafter: operator of) a lift installation has a statutory obligation to carry out maintenance work and periodic testing to ensure operating safety once a permitted number of operating hours has been reached (cf. Section 12 of the German Aeronautical Equipment Testing Regulation / German Industrial Safety Regulation 2015). Operations may only be resumed subsequent to this. The Federal Fiscal Court (*Bundesfinanzhof, BFH*) dealt with a case where the owner of an aircraft and a lift installation had passed on the costs associated with the maintenance obligation to the operator. The aircraft operator had to maintain the leased aircraft "in accordance with the provisions under aviation law" (with respect to operating hours) at its own expense. In the tax accounts the operator created a provision for maintenance and testing costs and, specifically, in instalments for the operating hours that had already elapsed in respect of the number of operating hours until maintenance. The local tax office and the tax court were of the opinion that the economic reason for the obligation had not yet arisen and deemed the creation of the provision by the operator not to be permissible. The appeal and the legal action were unsuccessful.

It is undisputed that operators are not allowed to create a provision for an obligation arising under public law. According to the BFH (ruling from 9.11.2016, case reference: I R 43/15, first instance: Düsseldorf tax court with its ruling from 21.4.2015, case reference: 6 K 307/13 K,G; EFG 2015 *(Entscheidungen der Finanzgerichte)* p. 1629), the creation of a provision may generally be needed for operators' obligations under civil law for a maintenance reserve/guarantee payments. In any case, this applies if when the contract expires there is no claim for a refund of the amounts and the taxpayer would therefore always remain burdened with the agreed amounts due to a contractual obligation. This decision was based on the grounds that it is necessary to compensate for impairments due to the assumption of maintenance costs that depend on operating hours.

» **Recommendation:** In comparable circumstances with contractual obligations under civil law the creation of a provision for operators' maintenance costs could be considered.

WP Dieter Hanxleden / Andrea Rupper

Focal points with respect to consolidated tax groups for income tax purposes

The preconditions for the recognition of a consolidated tax group for income tax purposes are the effectiveness under civil law of a profit transfer agreement (PTA, Sections 291 et seq. of the German Stock Corporation Act (*Aktiengesetz, AktG*)) as well as satisfying the requirements under tax law (Section 14, 17 of the German Corporation Tax Act (*Körperschaftsteuergesetz, KStG*)). In the event of the tax authorities querying the status of a consolidated tax group for income tax purposes then, in order to preserve it, a legal fiction under KStG that was introduced within the scope of the "small consolidated tax group reform" could be of help. In the following overview we highlight the most important issues and risks.

1. The effectiveness under civil law of a profit transfer agreement (PTA)

The effectiveness under civil law of a PTA is a mandatory precondition for the tax basis for a single-entity relationship for tax purposes. Under the German Stock Corporation Act, a PTA has to be in writing and have been approved at the Annual Shareholders' Meeting of the obligated and controlling German joint stock company (*Aktiengesellschaft, AG*) with a three-fourth majority of the share capital that was represented when the resolution was passed. Such a PTA only becomes effective after it has been added to the commercial register entry for the subsidiary company. The fiscal year in which this entry is made is relevant, for tax purposes, for the attribution of the income of the subsidiary company to the parent company. The Federal Fiscal Court (*Bundesfinanzhof*, *BFH*) has dealt with a case where a Local Court (Amtsgericht) was notified on 18.9.2006 that a PTA should be entered into the commercial register, however, due to a delay at the authority the entry was not made until 26.1.2007. The tax authority refused to recognise the consoli-

dated tax group for the period of 2006. The BFH also confirmed that the effectiveness of the PTA on the basis of an entry in the commercial register was a precondition for the creation of a consolidated tax group. Here, the BFH established that the legislator had deliberately not taken into account the effects and circumstances and had primarily based this precondition on the entry in the commercial register (cf. ruling from 10.5.2017, case reference: I R 93/15).

2. Compensatory payments to minority shareholders

Based on the BFH ruling from 2017, recognition of a PTA for income tax purposes should be withheld if the agreement on compensatory payments to minority shareholders (Section 304 AktG) includes a variable compensation component, in addition to a particular fixed amount, that is oriented towards the subsidiary company's income. The above-mentioned ruling also applies to other corporations as subsidiary companies.

3. Transfer of entire profit and tax loss carry-forwards that arose prior to tax consolidation

The key criterion according to Section 291(1) AktG is the transfer of the entire profit that has been determined in accordance with German GAAP. In the event that there are tax loss carry-forwards that arose prior to the tax consolidation then the net income for the period that has been determined by the subsidiary company should first be reduced by the current tax loss carry-forward that stems from the period prior to the tax consolidation. If the offsetting of the tax loss carry-forwards that arose prior to the tax consolidation is omitted then this would put at risk the actual implementation of the profit transfer for income tax purposes and would result in non-recognition. Before the "small consolidated tax group reform" came into force on 26.2.2013, in order to retroactively remedy the omission of offsetting losses and hence the tax consolidation for income tax purposes the recommendation was to modify the annual financial statements prepared according to German GAAP starting with the first year of the group tax consolidation or from the year when compensation for the tax loss carry-forwards was required. The tax authority usually recognised the retroactive modification of the annual financial statements prepared according to German GAAP due to error correction.

» **Please note:** When the small consolidated tax group reform came into force, in cases of so-called forgotten tax loss carry-forwards that arose prior to tax consolidation KStG started to regulate the possible path to correction via a modification of the annual financial statements of the subsidiary and the parent company (cf BFH from 21.10.2010, case reference IV R 21/07).

WP Dieter Hanxleden

AND FINALLY…

"A brand is something that has a clear-cut identity among consumers, which a company creates by sending out a clear, consistent message over a period of years until it achieves a critical mass of marketing."

Philip „Phil" Knight, born on 24.2.1938 in Portland, Oregon/USA, former accountant, founder and previous CEO of Nike.

Impressum

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