PKF

Newsletter

Key Issue

Taxation of real estate undergoing upheaval – taxation and valuation of real estate, real estate transfer tax and trade tax

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Dear Readers,

In this November edition of our newsletter, our Key Issue is the **taxation of real estate**. The important changes to various types of tax are the subject matter of the first three reports in our newsletter. First of all, we provide an overview of the **reform of real estate tax**. The draft law was published on 23.9.2019 and it looks like the legislation will be passed by the end of the year and will thus meet its deadline, although the clarifying circulars from the fiscal authority are indeed not expected until 2020. In the second article we take a look at the points that are still open as regards the **reform of real estate transfer tax** - in the future more transactions will be subject to this tax. Nevertheless, it is hoped that some urgently needed exceptions will also be created, for example, in the case of intra-group restructurings. Finally, using a recent Federal Fiscal Court ruling as a basis, we present the conditions under which rental income would not be subject to **trade tax.**

The second point of focus in our Tax section is the **new global tax system**. In Germany, when calculating intra-group allocations for the supply of goods and particularly services, there is also growing acceptance of common international transactional profit methods in addition to the traditional transactional methods. To begin with, we provide a detailed presentation for you of the **transactional net margin method (TNMM)**. Our second report is about the shifting of the tax base. The OECD has presented a model for the **taxation of the digital economy.** Within the scope of Pillar 1, the intention is to move the connecting factor for taxing rights away from having a local presence and towards markets. Under the 'unified approach' the overall profits would be divided up on the basis of the **profit split method**, which is likewise a transactional profit method that is being developed accordingly by the OECD.

In the Legal section we kick off with a discussion of the main features of the new **German Trade Secrets Protection Act**. In our second report, we answer the question of whether or not full **entitlement to paid leave** has to be granted if an employee has been released from the obligation to work, or only works some of the time.

We wish you an interesting read.

Your Team at PKF

Key Issue

Taxation of real estate undergoing upheaval – taxation and valuation of real estate, real estate transfer tax and trade tax

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TAX

RA [German lawyer] Johannes Springorum

Reform of the real estate tax and valuation law is on the home straight

We knew for a long time that real estate tax is in need of reform. Then, on 10.4.2018, the Federal Constitutional Court declared that the valuation rules were unconstitutional. According to the court's ruling, a new law has to be passed by 31.12.2019, otherwise no new tax assessments may be issued as of January 2020. In issue 1/2019 of our newsletter we presented the main features of the reform, which is now close to completion.

1. Aim – New rules that are consistent with the Basic Law

According to the Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)*, the key aim of the reform is "to rewrite the rules on real estate tax so that they are consistent with the Basic Law. Yet, in doing so, the municipalities should not make a profit – the total amount of property tax should remain the same." Moreover, the new rules, which were approved by the lower house of the German parliament *(Bundestag, BT)* on 18.10.2019 (BT printed matter 19/11085), should be "fair in that property tax should continue to be based on the value of a property." Therefore, social housing properties, municipal and non-profit housing associations and housing cooperatives should, under certain conditions, benefit from a discount on the base rate for real estate tax purposes.

2. The calculation of real estate tax

In the future, real estate tax will likewise be calculated in three stages: value x base rate for tax purposes x multiplier.

(1) Calculation of real estate value – The major factors are the respective value of the land (indicative land value) and the level of the statistically determined net rent exclusive of heating, lighting and other service costs. The latter

will depend on the so-called rental level *(Mietniveaustufe)* for the respective municipality – the higher the rental level, the higher the rent in a municipality tends to be. Other factors are the plot area, type of property and the age of the building. The classification of municipalities into rental levels will be carried out by the BMF, on the basis of data from the Federal Statistical Office, using the average rents in all 16 German federal states. In 15 of the 16 German federal states the individual factors can already be accessed via the so-called BORIS system (an abbreviation for *Bodenrichtwertinformationssystem*, an information system for indicative land values).

(2) Compensation for value appreciation – In order to compensate for value appreciations vis-à-vis current values the so-called base rate for tax purposes will be massively reduced to 0.034%, which is approximately 1/10 of the previous value of 0.35%. Furthermore, social housing construction as well as municipal and cooperative housing are also supposed to receive funding from real estate tax revenues. That is why an additional discount of 25% on the base rate for tax purposes is planned for companies that enable reasonably priced housing.

(3) Adjustment to the multipliers by the municipalities – If, due to the revaluation, the real estate tax revenue of individual municipalities changes then they would have the option of adjusting their multipliers and, in this way, ensuring that their overall real estate tax revenue does not change significantly. The municipalities have announced that they will indeed do this.

3. Real estate tax "C" on plots that are ready for development

In the context of the real estate tax reform, towns and municipalities would be able to set an increased, standard multiplier on ready-for-development plots in order to mobilise these for building on. The draft law amending the Real Estate Tax Act for the mobilisation of ready-for-development plots for building on, tabled by the German government on 23.9.2019 (BT printed matter 19/13456) provides for this.

4. Opening clauses for the German federal states

The German federal states have reached a compromise to the effect that, on the basis of a corresponding amendment to the Basic Law, they would generally also be able to introduce their own real estate tax models ("opening clause"). Some federal states (e.g. Saxony and Bavaria) have already announced that they want to provide for so-called value-independent models for their municipalities.

5. Changes for other types of plots

Unlike in the case of residential plots, for let commercial plots no statistical data are collected that could be used for the valuation. That is why, in this case, the simplified asset value method would be used as a guide for real estate tax purposes. This method is used to determine the value of a plot on the basis of the normal production costs for the respective type of building and the indicative land value.

While for the valuation of agriculture and forestry businesses (real estate tax "A") the income capitalisation method would continue to be used, nevertheless, it would be simplified and standardised. In future, determining real estate tax for agriculture and forestry businesses would be done on the basis of a standardised valuation for the stretch of land and the farmsteads.

Please note

The legislative package for real estate tax reform, which was passed by the Bundestag on 18.10.2019, still has to be approved by the upper house of the German parliament *(Bundesrat)* and promulgated in the Federal Law Gazette by 31.12.2019. However, it is considered to be certain that the reform will be finalised in good time before 31.12.2019. This is because the consequences of a failure to complete the reform would be too great for everyone (the federation, the states and the municipalities) and so failure is not an acceptable option.

RA/StB [German lawyer/tax consultant] Reinhard Ewert

Real Estate Transfer Tax – Latest developments in the legislative procedure

Since 2016, policy makers have been pursuing the aim of tightening up the real estate transfer tax (RETT) rules for so-called share deals. It is argued that, among things, RETT is always incurred when private individuals purchase their own homes, yet large real estate investors are able to avoid this tax through share deals.

A specific reform law is now the subject of a legislative procedure.

1. Evolution

The governmental draft "law amending the Real Estate Transfer Tax Act *(Gesetz zur Änderung des Grunderwerbsteuergesetzes, GrEStG-E)* was adopted by a resolution of the German cabinet from 31.7.2019 (for previous information about this please see our article in 07-08/2019 edition of the PKF Newsletter). This was followed by recommendations from the Finance Committee of the upper house of the German parliament *(Bundesrat, BR)*, on 6.9.2019. These were, in particular:

- a time limit for the recognition of changes of shareholders for determining new shareholder status for a corporation with a stake in a partnership,
- the introduction of a stock market clause,
- an adjustment to the corporate group clause for tax-exempt restructurings (Section 6a GrEStG) and
- non-recognition of transfers of shareholdings in the case of corporations before the GrEStG Reform Act comes into force.

Subsequently, on 20.9.2019, the Bundesrat – while mostly following the Finance Committee's recommendations – expressed its opinion on the governmental draft [BR printed matter 355/19].

2. Key points of the Bundesrat's opinion statement

(1) New shareholder status of corporations (Section 1(2a) clause 4 GrEStG) – The original draft law provided that any change of shareholder would be relevant for determining the new shareholder status of a corporation with a stake in a partnership. According to the proposal of the Finance Committee of the Bundesrat, this should be limited to a period of 10 years.

(2) Stock market clause (Section 1(2a) clause 7 and Section 1(2b) clause 7 GrEStG, amended version) – According to this, the provisions on changes of shareholders would not be applicable in the case of shareholdings held by stock exchange-listed corporations in real estate companies. In the view of the Bundesrat, while the constant changes of shareholders would basically mean that the prerequisites constituting abusive structures would be fulfilled, nevertheless, given the objectives of the investors this is not normally the case. However, exclusion on the basis of the 'stock market clause' should only apply if the shares admitted to trading constitute the vast majority of the capital of the stock exchange-listed corporation.

(3) Corporate group clause (Section 6a GrEStG) – Under the current Act, only specific restructurings among affiliated companies benefit from the exemption from RETT. In practice, numerous cases have arisen where, according to the legislative objectives, tax exemptions would be desirable but are not achievable under the current Act (e.g. in the case of direct transfers of real estate within a group or restructurings that involve holding companies). The planned extension of the GrEStG would further aggravate this 'precarious situation'. In the opinion of the Bundesrat, to better reflect the original intention of the German legislator an assessment should be made to determine if real estate transfers within a group could be entirely excluded from RETT without however opening up any new leeway for potentially abusive structures.

(4) Prohibition on retrospective laws (Section 23 GrEStG) – The Bundesrat recommended ruling out retroactive application of the new rules under Section 1(2b) GrEStG-E (change in shareholders of a corporation). The draft law provides for the recognition of transfers of shareholdings to corporations even before the new legal provisions come into force (probably as of 1.1.2020) if the definitive transaction imposing an obligation had not been completed before the draft law was forwarded to the Bundesrat (relevant cut-off date: 9.8.2019) and if this has not been completed within a period of one year after this cut-off date (i.e. at the latest by 8.8.2020). According to the proposal of the Bundesrat, the application of the new rules should be restricted to transfers of shareholdings that happen after 31.12.2019 so that the question of a potential retroactive effect would not arise.

3. The Federal government's draft law from 23.9.2019 and the response on 25.9.2019

The draft law tabled for a decision by the German government, on 23.9.2019, in the Bundestag was in line with the previously published draft law but had not yet taken into account the above-described proposals of the Bundesrat. The German government expressed its opinion on these proposals on 25.9.2019 and all four of the amendments proposed by the Bundesrat were approved. There were restrictions in only two points. In the case of the stock market clause, the specific form of the provision still has to be considered. Moreover, as regards the corporate group clause, the outcome of the proceedings currently pending before the Federal Fiscal Court *(Bundesfinanzhof, BFH)* relating to Section 6a GrEStG will first be awaited.

Outlook

All of the Bundesrat's recommendations should be welcomed and they would make a considerable contribution towards simplifying the application of the new GrEStG. Yet, the wording of the response by the Federal government to the proposals indicates that there will not be a quick solution. Both the enquiry into a possible stock market clause as well as the adjustment to the corporate group clause are likely to be very time-consuming and, at the very least, having to wait for the pending decisions of the BFH in relation to Section 6a GrEStG would accordingly appear to rule out any new provisions in the course of the current legislative procedure.

WP/StB [German public auditor/ tax consultant] Dr Matthias Heinrich /
StBin [German tax consultant] Julia Hellwig

Trade Tax – A new Federal Fiscal Court ruling on the extended deduction for owned real estate

In 2019, the Federal Fiscal Court *(Bundesfinanzhof, BFH)* has ruled on several cases related to the extended deduction for owned real estate for trade tax purposes. This subject matter frequently leads to discussions with the fiscal authority.

1. Simple vs. extended deduction for owned real estate

In the case of a simple deduction for owned real estate, 1.2 per cent of the assessed value of the real estate that belongs to business assets and is not exempt from real estate tax can be deducted from the company's profit. This therefore constitutes trade tax relief. Other conditions generally do not have to be fulfilled.

In the case of an extended deduction for owned real estate, companies that exclusively manage and use their own real estate can make a deduction of that part of their profits that is attributable to the management and use of that very same real estate. This thus effectively constitutes a trade tax exemption. It is not detrimental, from a tax point of view, if capital assets are managed and used alongside the real estate assets. The extended deduction will only be granted upon application and under narrowly defined conditions.

2. Selected BFH rulings from 2019

2.1 Operating equipment

The BFH, in its ruling from 11.4.2019 (case reference: III R 36/15) had to decide if a real estate management GmbH (a German limited company) that, besides a hotel building, had also let equipment such as, e.g., cold storage rooms or a beer cellar cooler system, should be allowed to make an extended deduction for owned real estate. In its ruling, the BFH adopted the opinion of the tax office that had refused to allow the extended deduction for owned real

estate. The extended deduction for owned real estate has been based on the premise that the real estate conforms to the definition under German valuation law. Under this law, the equipment that was let along with the building should have been classified as operating equipment and thus not as real estate. Accordingly, the GmbH was not exclusively managing and using real estate. The statutory provisions however include an exhaustive list of tax-privileged activities and, according to that, the management and use of operating equipment does not fall in this category. Nor is the letting of operating equipment along with the building absolutely essential for organising the management and use of real estate in an economically viable manner. Moreover, in view of the exclusivity required by law, there is no scope for a quantitative de minimis threshold.

2.2 A stake in a pure asset management partnership

The BFH, in its judgement from 6.6.2019 (case reference: IV R 11/19), made a decision subsequent to the ruling from 25.9.2018 (case reference: GrS 2/16) of the Large Senate. The facts of the case that formed the basis of this ruling were as follows. The claimant was a KG (German limited partnership) deemed to be of a commercial nature that held a stake in a pure asset management GbR (a company/partnership under German civil law). The KG had made an extended deduction for owned real estate on the basis of the rental income that it had derived from its stake. The tax office refused to allow this because the stake in the GbR did not constitute real estate owned by the KG, but rather real estate owned by the GbR.

The BFH did not share this view. For income tax purposes, a property owned by the GbR under civil law was property owned by the partners in the GbR. This is because, for income tax purposes, the so-called Bruchteilsbetrachtung (fractional parts approach) applies to the allocation of the business assets of a pure asset management partnership. Under this approach, business assets that have several joint owners must be allocated proportionally to the parties involved. Accordingly, the KG had to be allowed to make an extended deduction for its own real estate.

2.3. A stake in a partnership deemed to be of a commercial nature

The facts of the case relating to the BFH ruling from 27.6.2019 (case reference: IV R 44/16) also involved a KG deemed to be of a commercial nature whose business purpose was, particularly, the management of its own real estate. The KG in turn had a stake in a partnership that owned real estate and which, in contrast to the controlled company in the above-described case, was deemed to be of a commercial nature. The extended deduction that the claimant was seeking to make for the rental income generated from the stake was refused by the tax office. According to the BFH, the fractional parts approach was not applicable in the case in question, in contrast to the above-mentioned mentioned case under 2.2. Instead, in keeping with civil law, the business assets here should also have been allocated, for income tax purposes, to the joint assets of the partnership itself deemed to be of a commercial nature. Therefore, there was no ‘management and use of own real estate’ but rather the ‘holding of a stake’. However, the latter does not appear in the standard catalogue of activities that are not deemed to be detrimental from a tax point of view.

With this ruling the BFH confirmed its previous opinion and accordingly agreed with the tax office and likewise refused an extended deduction for owned real estate.

Please note

The above-mentioned judgements constitute just some of the various rulings on extended deduction for owned real estate. Nevertheless, these already demonstrate that the preconditions for an extended deduction for owned real estate have to be carefully scrutinised.

StB [German tax consultant] Dr Maximilian Bannes

Transfer pricing formation using the TNMM

The TNMM *(transactional net margin method)* is a transactional profit method for transfer pricing formation where the net margin of the supplying business is adjusted on the basis of the individual accounting transaction in accordance with arm's length principles. For a long time, the German fiscal authority has taken a rather critical attitude towards this method. Internationally, it has already been established for a longer time and is even accepted in German transfer pricing practice.

1. Basic principles of transfer price formation

Currently, fiscal authorities around the world are increasingly attempting to counteract the tax-driven allocation of profits for the exploitation of tax-rate differentials through regulations for determining transfer pricing. A purely unilateral approach, or adjustments that have not been agreed with other countries would result in double taxation on account of the different regulations for determining transfer pricing. In order to address the problem of double taxation, industrialised countries within the framework of the OECD have agreed specific transfer pricing methods, which admittedly have no direct legal effect but, nevertheless, have received widespread attention.

The OECD and national legislators have organised the various transfer pricing methods under the premise of the arm's length principle, according to which intragroup ('controlled') transactions have to stand up to an arm's length comparison at all times. Yet, the OECD and all the countries involved agree that transfer pricing is not an exact science. While the weaknesses of OECD transfer pricing methods are well known here, nevertheless they form a kind of convention and, to a large extent, all the countries involved adhere to it and have transposed the methods into national law.

2. Transfer price formation methods

As regards the classification of the methods for determining transfer pricing, a distinction is generally made between the so-called traditional transaction methods and the transactional profit methods.

2.1 Traditional transactional methods

For 'fully comparable' arm's length transactions, Section 1(3) of the External Tax Relations Act *(Außensteuerrecht, AStG)* provides for the priority of the traditional transactional methods. Accordingly, there remains no scope for the transactional net margin method as a transactional profit method.

Although, fully comparable arm's length transactions – thus, uncontrolled transactions with almost identical business conditions – are rarely observed in practice. If the transactions are comparable only to a limited extent then, besides the traditional transactional methods, the application of transactional profit methods also have to be considered.

2.2 Transactional profit methods

These determine the appropriate transfer price retroactively; in other words, after allocating a profit that conforms to arm's length principles in business terms the necessary transfer price is calculated from this.

While the fiscal authority has a critical stance towards transactional profit methods, an increasing acceptance of them has nonetheless been observed in practice. Moreover, since 2005, the fiscal authority has even officially allowed the use of the TNMM for entities with routine functions, i.e. businesses with simple functions and few risks. Since then the TNMM has been applied more and more frequently.

3. The mechanism of the TNMM

The TNMM differs from other methods in that it is a so-called one-sided method where, normally, only one of the parties is the subject of an arm's length analysis. That is why the TNMM usually involves an examination of an entity that only performs routine functions and not, however, its intragroup business partner. Consequently, the amount of the intragroup business partner's remaining residual profit is not included in the pricing structure. Furthermore, with the TNMM the main focus is rather on the functional comparability of the supplying business. Therefore, the functional and risk characteristics of the supplying business are analysed and less so the specific performance rendered (product or service). The TNMM thus strongly resembles the cost plus method (a traditional transaction method).

If an entity performs routine functions then a comparison is made between its net margin (generally the EBIT margin)

and the margin of independent suppliers/service providers, and the intra-group performance is then priced such that the target margin determined in this way, and which complies with the arm's length principle, is achieved.

In order to determine the net margin, the net profit is set in relation to an appropriate profit level indicator (PLI). In the case of sales entities, for example, the target EBIT margin would thus be fixed in relation to revenues. Such data from comparable companies are frequently readily available and, consequently, a database search will normally display a large number of profitability ratios, which in some cases will deviate greatly from one another.

Example: A German manufacturer opens an independent sales entity in Spain. A database survey shows that independent sales entities in this industry achieve a 2% EBIT margin on sales. The selling prices charged by the German manufacturer to the Spanish sales entity would be determined in such a way that the Spanish sales entity would likewise generate a 2% EBIT margin. The residual profit would remain with the German manufacturer.

An argument that the fiscal authority frequently brings forward against the TNMM is that the comparative profitability ratio is determined on a company-wide basis, but not – as actually necessary – on the basis of individual business relationships. However, this criticism is rooted in the transfer pricing method itself and can likewise be levelled against the cost plus method (a traditional transaction method), which is accepted by the fiscal authority.

Please note: Ultimately, the argument can only be refuted through a careful selection of comparable enterprises that engage solely in a comparable business activity.

4. An appraisal of the TNMM

The TNMM would be particularly suitable for the pricing of sales functions and services. In practical tax planning, this method is used in outbound cases, in particular also to avoid the consequences of a transfer of functions.

The opinion expressed in the literature is that the transfer of the sales function to an entity that performs routine functions (e.g. to a so-called limited-risk distributor) and the application of the TNMM would rule out the presumption of the transfer of a function, or significantly soften it because, ultimately, the residual profits would remain in Germany. The fiscal authority supports this view and makes reference to a statutory provision in Section 2(2) of the Regulation on the Application of the Arm's Length Principle (Verordnung zur Anwendung des Fremdvergleichsgrundsatzes, FVerlV), from the text of which it is actually not possible to ascertain whether or not the TNMM may be used. All the same, the fiscal authority is stretching the scope of application to also include the TNMM.

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

Taxation of the digital economy is on the horizon – OECD proposal for a unified approach

The OECD has responded to the new business models that have arisen in the course of the digital transformation and, on 9.10.2019, it presented a proposal for the allocation of taxing rights. A key aspect of this 'unified approach' is establishing a connection with sales irrespective of any physical presence. This concept will radically change the international tax system that has traditionally been based on subsidiaries and permanent establishments.

1. Unified Approach – Three become one and a new nexus

At the beginning of 2019, the Task Force on the Digital Economy deployed by the OECD presented three proposals as follows.

The user participation model – According to this, the users create value and the states where these users are based do not participate in the value creation (proposal for profit sharing via a residual profit split).

The marketing intangibles model – According to this approach, so-called marketing intangibles are developed in the state where the users are based.

Significant economic presence – This approach assumes that a digital permanent establishment is created that profits from its local presence through its digital activities.

All three approaches are aimed at extending the taxing rights for states where customers or users of the digital business models are located. On the basis of these three

approaches the OECD has now developed a 'unified approach'. This is supposed to form the so-called Pillar One, which addresses the assignment of taxing rights to market states. Here, the nexus for taxpayers would be based on sales irrespective of any physical presence.

2. Sequence of steps according to the unified approach

The approach provides for profits to be allocated irrespective of whether or not there is a subsidiary or a permanent establishment in the country where the digital sales are realised. A marketing or distribution presence or an independent sales partner would thus no longer be the prerequisites. Current transfer pricing rules would be retained but complemented with formula-based solutions. The OECD profit allocation approach consists of a three tier mechanism, which is however still quite abstract. For a better understanding of this approach, in the next section we provide a description of the sequence of steps that is clearer than the one in the OECD proposal:

- **(1)** Calculation of the **overall profit to be allocated** (e.g. group EBIT).
- **(2)** Calculation of the **residual profit** for the state where the head office is located and for the market states by deducting routine remunerations from the overall profit.
- **(3)** All the parties involved in marketing and distribution functions would receive **routine remunerations** from the residual profit.
- **(4)** The remaining profit would be divided up as follows. First of all, the state where the head office is located would receive a **minimum return**. If the remaining profit exceeds this minimum return then the market states would once again receive a **portion of the residual profit** and the other portion would remain in the state where the head office is located.
- **(5)** For special cases – for example, if a (market) state claims a greater share of the profit – a compulsory mutual **agreement procedure** would apply.

3. Uncertainties with regard to the application of the unified approach

The unified approach constitutes an intervention in current transfer price formation practice. If, up to now, prices have been formed on the basis of the arm's length principle then the unified approach would require a rethink. After the Federal Fiscal Court *(Bundesfinanzhof, BFH)*, in its ruling from 26.2.2019, overturned free transfer pricing by associated enterprises (Art. 9 OECD MTC) and decided on a substantive adjustment in accordance with the national standard (Section 1 of the German External Tax Relations Act), now it is the OECD itself that is making an intervention. Other uncertainties have arisen because, up to now, the scope of application has not been clarified. The proposal admittedly discusses consumer-related companies. This would certainly cover the 'B2C' area, but probably also B2B business models.

Outlook

The OECD proposal for Pillar 1 was released to the public for written comments until 12.11.2019 and this will now be followed by a public consultation meeting, which will take place on 21./22.11.2019. The draft for Pillar Two, which will focus on the issue of minimum taxation, is likewise expected in November. We will keep you informed.

LEGAL

RAin [German lawyer] Susanne Blask

Protecting trade secrets through adequate measures

The Act to implement the EU directive (EU) 2016/943 on the protection of trade secrets against their unlawful acquisition, use and disclosure *(Geschäftsgeheimnisgesetz, GeschGehG)* came into force on 26.4.2019 and, for the first time, created a stand-alone set of regulations. The GeschGehG however only protects holders of secrets who themselves have taken adequate protective measures.

1. Definition of a trade secret

According to the legal text, a trade secret exists if all of the following preconditions are satisfied:

- the information is not generally known, or
- is not readily accessible and
- has commercial value.
- Furthermore, this information has to be protected by measures for maintaining confidentiality.

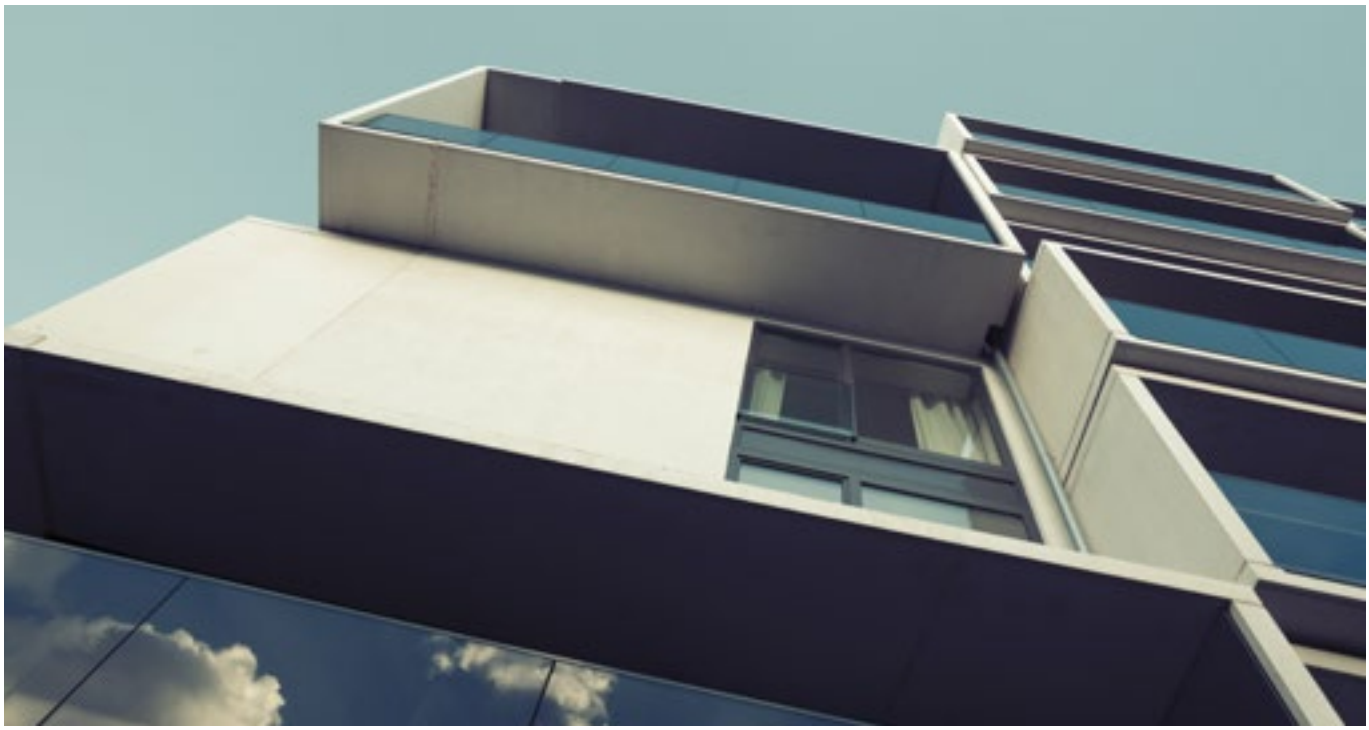
Ultimately, there has to be a legitimate interest for maintaining confidentiality.

2. Measures for maintaining confidentiality

The GeschGehG can only have a protective effect if adequate measures for maintaining confidentiality have been adopted and sufficiently documented by the holder of the trade secret (also the licence holder). According to the preamble to the statute, the type of measures for maintaining confidentiality that are specifically required will depend on the nature of the trade secret and the precise circumstances of its use. Physical access restrictions and precautions as well as contractual safeguard mechanisms should be considered. There is no requirement for separately labelling each piece of information that has to be kept secret. Instead, measures can basically be adopted for specific categories of information (e.g. technical access barriers), or through general internal guidelines and instructions, or even specified in employment contracts.

Please note: Possible qualifying features for the adequacy of protective measures could include:

- the value of the trade secret and its development costs,
- the nature of the information,
- its significance for the company,
- the size of the company,
- the usual measures for maintaining confidentiality at the company,



» the type of labelling of the information, as well as
» the contractual agreements with employees and business partners.

3. Other regulatory content

The GeschGehG has standardised the authorisations and prohibitions related to the acquisition, use and disclosure of a trade secret. For example, one thing that is expressly allowed is so-called reverse engineering, thus acquiring knowledge through the study, or even the disassembly of a product insofar as it is not protected by other property rights (e.g. patent, design).

Please note: The regulations also ensure that so-called whistleblowers are protected against prosecution. This is on condition that the individual who has uncovered a trade secret acted with the intention of protecting the general public interest.

4. Extending the scope for making claims

On the basis of the new GeschGehG, holders of trade secrets which have been infringed are able to make a significantly greater range of claims. Besides the existing rights to make a claim for ceasing and desisting, provision of information and payment of damages, holders of trade secrets are now also able to make a claim for destruction, surrender, recall, removal and withdrawal from the market. Moreover, the new regulations also include the right to claim for damages in the event of a refusal to provide information. However, the GeschGehG prohibits abusive use on the basis of claims arising out of trade secret infringements.

5. Scope of new regulations extends to court proceedings and criminal offences

The interests of the holders of trade secrets in keeping these confidential will be protected all the way through to court proceedings. In exceptional cases, the extent of this protection could mean that not only would the public be excluded but also even the counterparty would only be given restricted personal access. Furthermore, in disputes related to trade secrets, the successful party, upon application, would have the option to publish the judgement.

The criminal provisions related to secrecy violations that were hitherto defined in Sections 17 to 19 of the German Act Against Unfair Competition (old version) have basically been carried over into the GeschGehG, although in the corresponding provision the relationship between civil and criminal protection has been reversed. Formulation changes made in this connection were largely due to adjustments for the terminology and system of the GeschGehG.

Recommendation

While the GeschGehG strengthens the protection of trade secrets, nevertheless, it also requires companies to adopt adequate protective measures, although the need not maintain 'perfect' confidentiality. Therefore, every company should evaluate its current secrecy protection practices to determine whether or not they are fit for purpose.

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

No entitlement to paid leave during the release phase of partial retirement

Recently, the entitlement to paid leave and payment in lieu have frequently been the subject of supreme court rulings, which in some cases proved to be surprising outcomes and were not welcomed by employers (e.g. on forfeitability, PKF Newsletter 10/19, p. 11). However, according to a recent ruling from the Federal Labour Court *(Bundesarbeitsgericht, BAG)*, the all-clear can be sounded on the issue of whether or not entitlement to paid leave also arises during the release phase of an agreed partial retirement scheme (ruling from: 9 AZR 481/18).

1. The case in question – Partial retirement based on the so-called block model

The legal action was brought by an employee who had agreed to partial retirement based on the so-called block model. First of all, he continued to be employed for 16 months on a full-time basis (working phase) and, subsequently, released for 16 months (release phase). Over the entire period, he continuously drew a salary that had been calculated on the basis of the reduction in working hours. After the end of the release phase, he claimed payment

in lieu for a total number of 52 days of leave to which he would have been entitled for the period of his "paid" release. The BGH has now clearly rejected this.

2. The duration of leave is based on patterns of work ...

The court clarified that the number of days of leave should basically be determined by the relevant patterns of work. In this way it is possible to ensure periods of leave of equal value for all employees. If, instead of the usual five days, somebody only works on two days of the week then s/he would likewise only be entitled to 2/5 of the normal period of leave. Accordingly, for employees who are in the release phase of their partial retirement there would be "zero" working days included in the calculation of leave days, as these employees would have been discharged from the obligation to work during this phase. Therefore, for this period, they would not have any statutory entitlement to holiday leave. If the switch from the working phase to the release phase takes place during the course of the year then the entitlement to leave has to be calculated on a pro rata basis.

... and this also applies to any additional contractual leave

The BAG likewise clarified that these principles apply not only to statutory minimum leave but also to any additional leave that has been contractually agreed, unless the parties have expressly agreed something else.

Please note

With this decision the court's rulings continue to be consistent with the principle according to which, generally, no entitlement to leave can arise during periods where there is no obligation to work. This will also apply even if, during the period, (previously earned) remuneration is drawn, something that, for example, is normal in the case of a so-called sabbatical (cf. BAG ruling from 18.9.2018, case reference: 9 AZR 159/18).

LATEST REPORTS

RAin/StBin [German lawyer/tax consultant] Antje Ahlert

A reprieve for companies with electronic cash register systems

The German Act for the Protection Against Manipulation of Digital Basic Records (the so-called Cash Register Act) obliges companies with electronic cash register systems to retrofit their systems with a certified technical security system (a so-called TSS) from 1.1.2020. A TSS consists of a security module, a storage medium and a digital interface that are manufactured and provided by private suppliers. For information about the stipulations under Section 146a of the German Fiscal Code and the Federal Ministry of Finance's Administrative Regulations Governing the Application, from 17.6.2019, (which, in the meanwhile, are no longer published on the website) we would refer you to

the PKF Newsletter 10/2019. We had already commented there that equipping 2.1 m cash register systems throughout the German federal territory by 1.1.2020 would be illusory. There has now been a decision at the level of the Federal Government and the German federal states to grant a grace period that will apply until 30.9.2020. The reason for this is that there was, or still is a significant delay in the certification, manufacture and sale of the security equipment.

RAin/StBin [German lawyer/tax consultant] Antje Ahlert

Assumption of tax consulting costs by the employer in the case of a net pay agreement

The German subsidiary of a global group had negotiated net pay agreements with the employees who it had posted to Germany. In the above-mentioned case, the pay agreements provided for the preparation of tax returns for the employees by a tax consultancy commissioned by the employer. The costs incurred for the consultancy were settled by the employer. The employees, in turn, assigned their tax refund claims to the group.

The Federal Fiscal Court *(Bundesfinanzhof, BFH)*, in its ruling from 9.5.2019 (case reference: VI R 28/17) has now decided that the assumption of tax consulting costs by an employer does not result in employee remuneration. Employers that assume tax consulting costs are not compensating their employees but acting primarily in their own business interests. Through optimal tax advice and by assigning tax refund claims employers are able to reduce their payroll expenses. The economic benefit from taking this approach thus lies with the employer.

Please note: The ruling can also be applied to domestic (German) issues. This is because, in the view of the BFH, it is not of general relevance that the employee in the case in question was posted to Germany from abroad.

RA [German lawyer] Johannes Springorum

Interest rate on tax arrears to remain at 0.5% per month for the time being

Given that we are in a phase of persistently low interest rates, for a long time now, there has been a debate on the issue of the constitutionality of the statutory level of the interest rate of 0.5% for each full month payable on tax arrears. In 2018, the Federal Fiscal Court *(Bundesfinanzhof, BFH)* expressed considerable misgivings, in terms of compatibility with constitutional law, against the interest rate level pursuant to Section 238(1) of the Fiscal Code *(Abgabenordnung, AO)* and granted a suspension of the operation of interest (BFH from 25.4.2018, case reference: IX B 21/18; from 3.9.2018, case reference: I B 15/18).

Recently, to address this problem, an application was filed by the FDP parliamentary group in the *Bundestag* (lower house of German parliament) for the amendment of the interest rate in accordance with Section 238(1) AO. The application was for the interest rate on tax arrears to be amended to a realistic level. Here, the draft proposal included a change in the amount of one twelfth of the base monthly rate of interest, within the meaning of Section 247 of the German Civil Code, but at least 0.1% per month.

Nevertheless, the Federal government continues to adhere to the current rate of interest. To substantiate this, the Finance Committee explained that, for the interest rate on tax arrears, the Federal government is guided not by market interest rates but, instead, by the rates of interest charged for defaults and overdrafts. Therefore, it does not agree with the BFH's criticism of the interest rate level.

Please note: It is nevertheless recommended to keep appeal proceedings open, particularly as the reason given by the Federal government to justify the interest rate level, namely that this is based on the rates of interest charged for defaults and overdrafts, contradicts the view of the BFH. While the annual preview of the Federal Constitutional Court gives some hope that there will still be a ruling this year on the constitutionality of the interest rate for assessment periods after 31.12.2009 or after 31.12.2011, yet, an imminent and overdue adjustment of the text of the law to reflect the actual economic conditions is however once again receding into the distant future.

PKF

AND FINALLY...

"Among the many factors that have promoted economic change, I believe that technology or, rather, change in technology is the most prominent. I realize that it is dangerous to look for 'ultimate causes' in a world where everything seems to depend on everything else. But I believe that for the most part the economy, and ultimately the society, must adapt to the conditions that technology creates. If it cannot adjust to the challenges of changing technology, it fails."

Wassily Leontief, (born 5.8.1906 in Munich – died 5.2.1999 in NYC) was a Russian-American economist who received the Alfred Nobel Memorial Prize in Economic Sciences in 1973.

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