PKF

Newsletter

Key Issue

Draft of the 2019 Annual Tax Act

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Dear Readers,

This year, the German legislator has been early and has already presented a draft for the **2019 Annual Tax Act**. In the last issue of our PKF Newsletter we already reported on the new aspects with regard to electromobility. Under the Key Issue for this edition, we explain some of the other changes with a particular focus on VAT. There will thus be sufficient time to be able to make adjustments to tax compliance systems, particularly in the VAT area.

In the meanwhile, permanent establishments are being identified at an almost inflationary rate. It is normally the German legislator or the tax authority that takes the initiative here. However, in the second contribution in our Tax section, you can read about how the Federal Fiscal Court is now joining in here, too, and has identified the **residence of a managing director as a permanent establishment**. The two subsequent contributions deal with communities. Our first report concerns **communities of part owners** and the fact that they do not constitute business entities from a VAT point of view. You can then read about what should be borne in mind if, in a business partnership, a **new partner** joins and the **profit allocation** deviates from the tax norm. Finally, we discuss another speciality from the arena of international tax law. Somewhat surprisingly, the Federal Fiscal Court has made it lawful for the German tax authorities to **attribute profits by way of derogation** from the rules under DTAs.

In the first report in the Legal section, we present the draft of an act whose purpose would be the resolution of **disputes** – by means of a three-stage procedure – related to double taxation in the EU in cases where there are **DTAs**. In the second article, we make a distinction between a **capital account on the assets side** and loan claims against a partner. Following on from that, we deal with the risk of **late payment penalties** when **social security contributions** have not been paid. The threat of an interest charge at 12% p.a. is already punitive in nature and ignorance cannot be used as an excuse here.

In the Accounting & Finance section, we discuss in detail the recognition and measurement of **cloud software**. We describe how accounting needs to evolve here and distinguish between the three operating models - IaaS, PaaS and SaaS. The related topic of customisation is also dealt with.

We hope you have a lovely summer and a relaxing holiday while reading this newsletter.

Your Team at PKF

Key Issue

Draft of the 2019 Annual Tax Act

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TAX

StBin [German tax consultant] Sabine Rössler

Draft of the 2019 Annual Tax Act – New VAT regulations and other important individual measures

Averting abusive tax structuring and the necessary adaptations of German tax laws to bring them into line with court judgements were the reasons behind the publication, on 8.5.2019, by the Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* of a draft bill for the proposed "Act to promote further tax incentives for electromobility and to amend other tax regulations". We already discussed the tax incentives for electromobility in our PKF Newsletter 6/2019. Other significant new regulations are set out below, in particular those relating to VAT. In addition, we have provided information on the affiliation privilege for trade tax purposes, real estate transfer tax in the case of share deals and subsistence expenses.

1. New VAT regulations

1.1 No tax exemption for intra-Community deliveries without an RS

A new criterion for the tax exemption of intra-Community deliveries will be the submission of a correct, so-called, recapitulative statement (RS) in accordance with Section 4 no. 1b of the of the VAT Act-Draft *(Umsatzsteuergesetz-Entwurf, UStG-E).* The preamble to the law could be understood to imply that, first of all, the tax exemption should be granted. However, if a business subsequently fails to submit an RS then the exemption would be refused in the following month.

1.2 VAT ID no. and tax registration of the recipient

Another requirement for the tax exemption of an intra-Community delivery, besides submitting an RS, is that the customer has to be registered in another member state and has to use a valid VAT ID no. vis-à-vis the supplying business (Section 6a UStG-E). As a result, this would introduce an explicit request for a VAT ID no. It is still open as to what action should be taken if, subsequently, it becomes apparent to the suppliers that the recipient's VAT ID no. is not valid.

Please note: Notwithstanding the new regulations, Section 17a et seq. of the German VAT Implementing Ordinance shall continue to apply. Thus, despite a considerable tightening up of the rules, the 'normal' Confirmation of Arrival document may continue to be used as proof that the delivery was tax exempt.

1.3 Adoption of Section 6b UStG for consignment warehouses

Under this new regulation, the source of which was the new Article 17a of the Directive on the VAT System *(Mehrwertsteuersystem-Richtlinie, MwStSystRL),* the rules for consignment warehouses in the Single Market will be applied in a consistent manner. Germany will now likewise be able to make use of the simplification rule according to which the transfer of goods from another EU member state to a consignment warehouse located in Germany, or vice versa, would not yet lead to an intra-Community purchase occurring at that stage. As a result of the new provision the obligation to register abroad for tax purposes will cease and only one transaction will have to be reported (the intra-Community delivery) and no longer three (the intra-Community transfer, the intra-Community purchase and the inactive supply in the state of destination).

According to Section 6b UStG-E, the supply transaction has to exhibit the following features in order to fall under the consignment warehouse rule:

» the supplying business knows the future purchaser's complete name and address at the point in time when the transport or dispatch operation begins;
» the supplying business has neither a registered office nor a permanent establishment in the Member State of the destination;
» the purchaser has used - vis-à-vis the supplying business - its VAT ID no. issued in the destination country.

1.4. Chain transactions

Article 36a MwStSystRL constitutes a regulation that, for the first time, has been created to be applied consistently to chain transactions throughout the EU. The previous provisions under Section 3(5) and (6) UStG will be transferred to a new Section 3(6a) UStG-E. This provision would regulate EU-related chain transactions as well as domestic chain transactions and those in relation to third countries.

The previous regulations will remain in force in cases where the transport has been arranged by the first or the last business. This means that, in each case, the delivery would have to be classified as the one coming from the first business or going to this last business.

If the transport is arranged by an intermediary then the transfer of the supply has to be attributed to the intermediary. If, in the process, the intermediary uses a VAT ID no. from the state of departure then the transport would have to be attributed to the intermediary's delivery. When determining the active delivery it is then no longer important to know who arranged the transport. This is a new rule and it still has to be tested. According to the preamble to the law, it should be sufficient if the intermediary documents that, vis-à-vis its supplying business, it has declared that it wants to use the VAT ID no. issued to it by the state of departure of the goods for all future deliveries.

Please note: In addition, a similar intermediary rule has been introduced for third country-related export chain transactions.

1.5 A reduced VAT rate for e-books

In the future, a reduced VAT rate of 7% will apply to books, newspapers and periodicals in electronic form. There will be no VAT concessions for, among other things, access to:

» search engines even if they display excerpts from the found documents,
» news sites where there are links only to press agencies or similar and with no proprietary editorial content,
» other collections of unedited texts,
» internet forums and social media platforms where the contents are essentially user-generated, and
» map data, e.g. for navigation devices.

2. Affiliation privilege for foreign dividends

On this point the draft bill has complied with the ECJ judgement from 20.9.2018 (case: C-685/16), according to which the provision in Section 9 no.7 of the Trade Tax Act *(Gewerbesteuergesetz, GewStG)* is contrary to EU law. In the future, the affiliation privilege for foreign dividends under Section 9 no.7 GewStG will continue to allow the deduction of dividends for trade tax purposes in

the case of shareholdings of at least 15% in corporations whose management and headquarters are abroad. The hitherto applicable restrictive preconditions for foreign corporations, especially the requirements for the gross revenues of subsidiaries and for the profits from second-tier subsidiaries, will be dropped. The discrimination between domestic (German) and foreign shareholdings as well as between EU and third country shareholdings will thus be eliminated.

Please note: The new regulation would apply from 2020. For the transitional period, the BMF had already mandated, on 25.1.2019, in the identical decree of the federal states, that the provision under Section 9 no.7 GewStG, to which the ECJ had objected, should not be applied to any of the open cases.

3. Tightening up of the treatment of share deals for real estate transfer tax purposes

The real estate transfer tax rules in the case of share deals are going to be tightened up. In particular, the shareholding limits in Section 1(2a), (3) and (3a) of the Real Estate Transfer Tax Act *(Grunderwerbsteuergesetz, GrEStG),* which are harmful from a real estate transfer tax point of view, will be reduced from 95% to 90% and the period in Section 1(2a) GrEStG will be extended to ten years in order to make arrangements for the avoidance of real estate transfer tax less attractive. A new Section 1(2b) GrEStG-E would cover changes of ownership at corporations in the same manner as has been the case with partnerships up to now. For both constellations, a transfer of at least 90% of the shares within a period of ten years would be subject to tax. There would be no requirement for the ownership stake as described above to be consolidated into a single holding.

Please note: The purchase transactions affected will be the ones that are realised after 31.12.2019.

4. Higher daily meal allowances

If employees work away from their homes or primary workplaces then, if they are absent for more than 24 hours, in future, they would be able to deduct € 28 (previously € 24) as work-related expenses. For the arrival day and the departure day and for more than 8 hours of absence (without an overnight stay) the allowance in each case would be increased from € 12 to € 14. Employers may reimburse an employee's expenses at a flat rate in this amount free of tax. The changes would be applicable from 1.1.2020.

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

Foundation of a permanent establishment due to the residence of a managing director

In Germany, national requirements determine whether or not an agency permanent establishment exists and thus also the limited tax liability there. These conditions have been specified by administrative opinion and court rulings. The Federal Fiscal Court *(Bundesfinanzhof, BFH),* in its latest ruling, has now widened the scope.

1. Requirements of an agency permanent establishment

Section 13 of the Fiscal Code *(Abgabenordnung, AO)* requires that business be conducted in a sustained manner; this generally implies working repeatedly and more than just for a short time on the basis of a voluntary decision made in advance. Sporadic and/or occasional postings and/or the work of representatives would be insufficient.

2. The case in question – A Luxembourg-based corporation

In autumn 2018, the BFH ruled on a case that involved a Luxembourg-based corporation. Its commercial transactions were conducted by the majority shareholder and, at the same time, sole managing director (M) primarily at the company's offices in Luxembourg. Among other things, M also owned an apartment in the German border area where he would likewise conduct commercial transactions on behalf of the company.

The German tax office was of the opinion that, in view of these commercial activities in Germany, M was a permanent representative for the company within the meaning of Section 13 AO and that the latter was subject to limited corporation tax liability in Germany.

The tax court that dealt with this case did not accept the argument made by the tax office. Instead, while making reference to so-called organ theory in German law (Organtheorie) – according to which there is mutual exclusivity between acting as a managing director and acting as a representative – the court held that M, as an organ of the corporation, could not be the company's permanent representative as well. The tax office lodged an appeal with the BFH against this ruling.

3. The BFH views acting as an organ as acting as a representative

The view of the tax court was rejected by the BFH in its ruling from 23.10.2018 (case reference: I R 54/16). The requirements under Section 13 clause 1 AO, according to the wording, could also be fulfilled by persons acting in their capacity as an organ of a legal entity. Managing directors could accordingly, at the same time, be permanent representatives and thus justify a limited corporation tax liability for a foreign company in Germany.

Furthermore, also according to the wording of the AO (e.g. Section 34(1), Section 79(1) no. 3 AO) acting as an organ should be viewed as acting as a representative. Moreover, the history of Section 13 AO as well as the teleological interpretation accordingly provide no indication of any narrowing of the definition of a permanent representative.

4. The change in case law is contrary to the opinion that hitherto prevailed

Up to now, there had not been a supreme court decision on whether or not the managing director of a foreign corporation could be a permanent representative within the meaning of Section 13 AO. With the above-mentioned ruling, the BFH has gone against the previous decisions of the financial courts and prevailing opinion that the organ theory in German law is also applicable to tax law. The managing directors of foreign companies will no longer be able to invoke this theory if they work in Germany.

Recommendation

As a result of the expansion of the concept of a permanent establishment, to include the organs of a corporation, even closer attention should be paid as to whether or not a foreign legal entity might possibly have founded a permanent establishment in Germany. In order to avoid having unclear information you should document the managing director's abodes and business transactions.

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

A community of part owners does not constitute a VATable business entity

Communities of part owners are not business entities from a VAT point of view. The Federal Fiscal Court *(Bundesfinanzhof, BFH)* recently decided this in its ruling from 22.11.2018 and thus changed its previously held legal position.

1. Issue – VAT in the case of grants of licenses

In the case that the BFH ruled on, (case reference: V R 65/17) the claimant, together with other persons, had invented methods for the early detection of tumours. In order to market the system the inventors had concluded a license agreement with a German limited partnership *(Kommanditgesellschaft, KG)*. The KG issued credit notes addressed to the inventors that listed the respective shares of the royalties of the inventors and showed the standard rate of VAT of 19%.

The claimant paid tax on his respective share of the royalties as a sole trader at the reduced VAT rate. The tax authorities objected to the application of the reduced VAT rate and issued an amended tax assessment notice. Subsequently, the claimant argued that it was not him but, instead, the community of part owners, which consisted of him and the other inventors, that constituted the supplying business. Therefore, it was the community of part owners that was liable to pay the VAT for the grant of licence vis-à-vis the KG.

2. Community of part owners is not the supplying business entity

In its decision the BFH ruled that a community of part owners did not constitute the supplying business entity and, therefore, the claimant was liable to pay the VAT on his respective share of the royalties and, namely, at the standard rate. To substantiate this, the BFH explained that a community of part owners cannot be a business entity from a VAT point of view due to its lack of legal capacity. Despite this, in the view expressed hitherto in case law and by the tax authorities, a community of part owners had been considered to be a business entity for VAT purposes.As a service provider and service recipient the community had been authorised to make input

tax deductions and obliged to pay VAT. The BFH no longer accepts this view.

The entity that provides a service or receives a service will be governed by the legal relationship that underlies that service and the assessment of this will normally be determined by rules under civil law. According to these, a community of part owners may not incur any liabilities and thus may not provide any VATable services. Therefore, the provider is not the community of part owners but its co-owners. The services that are provided proportionally by the respective co-owners, as business owners, have to be taxed by them. Accordingly, a community of part owners will not be authorised to issue invoices.

Another effect of the change to case law is that, from a VAT point of view, communities of part owners cannot be recipients of services. These will be the individual co-owners in accordance with the size of their stakes. Therefore, the input tax deduction can only be ensured if the incoming invoices are issued pro rata to the respective co-owners.

Please note: The ruling will have consequences not only for communities of inventors. Other communities of part owners, in particular joint property ownership associations in the real estate sector will likewise be affected by the BFH's decision. The ruling will not impact companies under civil law (Gesellschaften bürgerlichen Rechts, GbR) and associations of co-owners of apartment buildings under the Residential Property Act (Wohnungseigentumsgesetz, WEG) as these have legal capacity and can thus be business entities within the meaning of the German VAT Act.

Recommendation

Affected parties should closely monitor the response of the tax authorities in order to be able to react to any changes in good time. In cases of doubt you should seek advice in order to be able to evaluate the potential legal consequences that could arise.

RA [German lawyer] Johannes Springorum

Profit sharing when joining an asset management company under civil law

A change in a hitherto valid profit allocation formula for an asset management company under civil law (Gesellschaft bürgerlichen Rechts, GbR) such that partners who join the GbR in the course of its financial year will have income surpluses or income-related expense surpluses – which are attributable to the new partner's stake in the business – allocated for the entire financial year, has to be recognised under tax law. According to a new ruling by the Federal Fiscal Court *(Bundesfinanzhof, BFH),* this shall in any case apply where such a profit allocation that differs from the ownership structure is put in place for the future and approved by all the partners. The reason for the divergence in the profit allocation has to be related to the ownership structure and may not constitute an abuse of the law.

1. Loss allocation in the case of a change of partner

In a case heard by the BFH in autumn 2018, three partners each held a one-third stake in a GbR that was generating income from letting and leasing. One of the partners sold his stake to a new partner who then joined the company. Under the notarial agreement, concluded in October 1997, the transfer of the partner's rights upon payment of the purchase price was supposed to happen in that same year. However, the purchase price was only paid on 30.6.1998. Therefore, the change of partner did not occur until that point in time. In 1998, the GbR generated a loss in the amount of approx. € 0.6 m. The tax office allocated this loss to the remaining partners at a third each and one sixth of the loss each to the partner that had left and to the new one who had joined. The subsequent legal action brought before the tax court by the partner who had newly joined – where he sought to have a third of the loss for the entire financial year allocated to him – was successful.

2. Reasons for the decision

The BFH, in it ruling from 25.9.2018 (case reference: X R 35/17) confirmed the decision of the tax court and awarded the new partner who had joined the company the loss for the entire 1998 financial year that corresponded to the size of his stake. In the case of an asset management GbR, the allocation of profits or losses should generally be based on the size of the stakes in the company. The claimant's stake

would accordingly have been just one sixth because his one-third stake had only existed for half a year.

However, according to the BFH, the partners may deviate from this statutory provision, within very narrow limits, on a contractual basis. The precondition is accordingly that such a profit allocation, which differs from the ownership structure, has to be put in place for future financial years and approved by all the partners. Moreover, the reason for any changes has to be related to the ownership structure and may not constitute an abuse of the law. If these conditions are complied with then partners who join in the course of the financial year may also participate in the profit or loss that was generated prior to them joining the company.

Please note

The BFH has loosened its previous interpretation of the law in this respect. However, it did not decide whether or not, in the case where, under the German Law of Obligations, an asset management partnership changes its profit/loss allocation during the course of a financial year and applies this retroactively to the start of the year, this should be recognised for tax purposes, too.

LEGAL

RA [German lawyer] Frederic Schneider

New rules for DTA-related dispute resolution

The Act on the Resolution of Disputes between Germany and other EU Member States (EU-Doppelbesteuerungsabkommen-Streitbeilegungsgesetz, EU-DBA-SBG) shall apply to all complaints about double taxation of income or capital, between EU states, that have been lodged since 1.7.2019. Here, the temporal scope of application of the EU-DBA-SBG shall cover cases that relate to tax periods beginning after 1.1.2018. The EU-DBA-SBG is currently still at the draft bill stage. In terms of its contents, the draft bill is closely based on the underlying EU directive. It can be assumed that this version of the Act will come into force.

1. Regulation of the competent authorities

With EU-DBA-SBG the legislators in Germany will be complying with Council Directive (EU) 2017/1852 of 10.10.2017 on tax dispute resolution mechanisms. As the EU-DBA-SBG is currently still at the draft bill stage and the above-mentioned EU Directive was however supposed to be implemented by 1.7.2019, the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) is planning retrospective applicability of the Act back to 1.7.2019.

Please note: As the EU-DBA-SBG will be an Act that works solely to the advantage of the taxpayer such a retroactive effect would be rated as being unproblematic.

The EU-DBA-SBG will provide for the Federal Ministry of Finance to be the competent authority in Germany that, in turn, will mandate the Federal Central Tax Office to perform the functions in accordance with the EU-DBA-SBG. The competent court will be the Cologne tax court, which is the locally competent one for the Federal Central Office. The dispute resolution mechanisms shall generally take priority over the mechanisms under a DTA or the EU Arbitration Convention.

2. Three-stage dispute resolution procedure
2.1 Lodging the dispute resolution complaint

In the first phase, the taxpayer that has been affected by a double taxation issue will have to file a request – simultaneously and with the same information – with each competent authority in the member states concerned in order to initiate a mutual agreement procedure. This request shall include:

» the personal identifiers of the person concerned (name, address, tax identification number,...),
» a list of the Member States concerned,
» a statement about the tax periods to which the point at issue relates,
» precise details of the important facts and circumstances of the case with copies of all supporting documents, and
» references to national regulations and agreements.

Furthermore, the request has to include the stated opinion of the person concerned indicating the reasons why

the point at issue exists. There is a three-year deadline here for lodging the complaint after the first notification of the action (e.g. issue of a tax assessment notice) that ultimately gave rise to the point at issue. A decision by the respective competent authorities as to whether to accept or reject the complaint should generally be made within six months by the competent authorities in the EU states.

2.2 Phase 2 – Mutual agreement procedure

Once the competent authorities in the EU states concerned have made known to the person concerned as well as the other competent authorities concerned that they have accepted the dispute resolution complaint then the point at issue should be resolved within two years using a mutual agreement procedure. As soon as the competent authorities reach an agreement on the point at issue then the Federal Central Tax Office shall immediately notify the taxpayer about the agreement. The notification shall be made even if the authorities have not been able to agree.

2.3 Arbitration procedure with an advisory commission

If the competent authorities are not able to come to an agreement in the course of the mutual agreement procedure then, upon request by the taxpayer, an arbitration procedure will follow. In this third phase, the contentious issue will be presented to the so-called advisory commission, which will issue an opinion on how, in its view, the case should be resolved. As this so-called advisory commission is a key element of the draft bill, the EU-DBA-SBG also lays down more specific arrangements concerning the advisory commission procedures, such as: the composition, appointment term, rights to information and the rules of procedure.

The commission shall consist of a chairperson, a representative from every competent authority concerned and always an independent person from each EU state concerned. The independent persons will be chosen by each competent authority from a list that has to be forwarded by the latter. The opinion of the advisory commission will then be sent to the competent authorities in the EU states concerned. Subsequently, the competent authorities in the EU states concerned will decide once again how the point at issue should be resolved. In doing so, the competent authorities can follow the opinion of the advisory commission or else deviate from it.

As an alternative to resolving the point at issue through an advisory commission, the competent authority in Germany, together with the competent authorities in the EU states concerned, could appoint a commission for an alternative dispute resolution. This commission could also be appointed as a permanent body.

Please note

The draft of EU-DBA-SBG provides for simplifications for natural persons and smaller enterprises. For example, they will only have to lodge their dispute resolution complaints with the competent authority in their countries of residence.

RAin [German lawyer] Yvonne Sinram

Social security – Late payment penalties only in cases where there is awareness of the obligation to pay contributions

In the past, late payment penalties in the amount of 12% per year have frequently significantly increased the amounts payable in the additional assessment notices issued by the Deutsche Rentenversicherung *(German Federal Pension Scheme).* According to a recent ruling from the Federal Social Court *(Bundessozialgericht, BSG),* from now on there will be considerably greater opportunities to avert late payment penalties being charged. The prerequisite for this is that the employer or the party that is liable to pay the contributions must be able to demonstrate that the failure to pay social security contributions was not an intentional act.

1. Precondition for charging late payment penalties

The Deutsche Rentenversicherung may not charge penalties for overdue claims in respect of contributions if:

- » the party that is liable to pay the contributions did not have any knowledge about the payment obligation,
- » the party cannot be held responsible for this lack of knowledge,
- » the party cannot ascribe knowledge or the responsibility to another body either.

2. Employer's awareness of a payment obligation

Late payment penalties will always be incurred if an employer had been aware of the obligation to pay social security contributions for an employee. In-depth specialist knowledge would certainly not be required in such a case. Although, if the employer, based on experience, had presumed that an employment relationship had existed between the employer and an employee and that this entailed an obligation to pay contributions then it must be presumed that the employer did indeed have this knowledge.

Please note: By contrast, an error relating to the employer status would rule out this knowledge.

The BSG, in its decision of 12.12.2018 (case reference: B 12 R 15/18 R), has now clarified the point at issue of when you can be held responsible for a lack of knowledge to the effect that, in the case of an employer, there has to have been (conditional) intent in relation to the lack of knowledge. The employer would have had to have assumed that there was possibly a payment obligation but nevertheless condolingly accepted that there could be a violation. By contrast, up to now, the social security agencies had considered a negligent lack of knowledge to be sufficient

3. Negligence or intent?

Distinguishing between (gross) negligence and (conditional) intent is difficult. Conditional intent should, for example, be presumed if:

- » the employer had failed to evaluate and implement a report on the external audit of payroll tax from the point of view of social security law;
- » the employer's evaluation of specific employment

relationships deviated from business practice that had been in place for years and from well-known supreme court rulings.

By contrast, the court still considered the failure to initiate a voluntary status ascertainment procedure as a negligent lack of knowledge and therefore non-culpable, otherwise the, by law, voluntary procedure would effectively be mandatory.

4. Whose knowledge matters?

Knowledge or a culpable lack of knowledge by the representative body (management) would be attributable to the employer. Here, the knowledge of one member of this body would be sufficient. Furthermore, an employee's knowledge or culpable lack of knowledge would be attributable to the employer if the employee had been entrusted with the autonomous evaluation of occupations in relation to social security law.

Please note: Furthermore, it is also possible that the knowledge of other responsible individuals within a company hierarchy would be attributed to the employer concerned if, within the scope of compliance management, these individuals had not created an organisational structure in order to record the respective information and transmit it internally.

Recommendation

If, in the past, late payment penalties were based on the negligent lack of knowledge then you should contact your PKF consultant. The reason is that, under certain circumstances, a request for a review pursuant to Section 44 of Volume X of the German Social Security Code can be filed even for final notices of assessment.

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

Treating a partner loan on the assets side as a capital account and not as a liabilities account

Withdrawals from partnerships can be disbursements from capital accounts or can lead to a loan relationship between the company and the partner. If the disbursements result in an asset item on the balance sheet then attention should be paid to the precise classification for tax purposes.

1. Changes in the capital account

The classification would have implications, in particular, for changes in the capital account within the meaning of Section 15a of the Income Tax Act (Einkommenssteuergesetz, EStG), thus for the question as to the ability to compensate for losses. If loan disbursements have been made to a partner then this will not affect the development of the capital account within the meaning of Section 15a EStG. It is undisputed that partner loan accounts that have turned negative as a result of disbursements that are not permitted under the partnership agreement establish a claim by the company against the partner insofar as the disbursements have been made at arm's length terms (e.g. interest payments). Therefore, when determining the capital account this claim should no longer be included. If the transfer were made for no consideration then the loan account would become a (negative) capital account.

2. Impact of withdrawals

It is however open as to whether or not partner accounts that have turned negative as a result of withdrawals that are permitted under the partnership agreement likewise give rise to a claim by the company. A view that is frequently expressed in this regard is that permissible profit advances do not establish any claims by the company against the partner because the company is not entitled to repayment of these at any time. Consequently, partner accounts that become assets as a result of permissible withdrawals should be reported as negative capital accounts

Recommendation

You should be very careful when structuring loan accounts and capital accounts under the partnership agreement in order to avoid unpopular tax consequences, especially in the event of losses, particularly as the tax offices are taking up this issue more and more frequently in tax audits.

ACCOUNTING & FINANCE

Philipp Steinau

The accounting treatment of cloud-based software

The ongoing development of the digital world is repeatedly leading to new manifestations of well-known issues that then have to be re-evaluated in accounting. For example, just recently, new forms of software use have become established. While, previously, software was frequently still acquired on physical data carriers and installed on individual end devices, now, cloud-based software solutions are increasing in significance.

1. How cloud-based software works

In the case of cloud-based software solutions, the software runs on a central server (the "cloud") that users can usually access via their browsers. In the respective use, a distinction is essentially made between three operating models:

(1) Infrastructure as a Service (IaaS) – In the IaaS model, storage space or even a proprietary server is made available to a company by a cloud provider. The company itself installs and operates the software on the server.

(2) Platform as a Service (PaaS) – The PaaS model merely comprises the provision of a development platform on which users are then able to develop their proprietary software.

(3) Software as a Service (SaaS) – In the case of the SaaS model, the software is made available for use by the software provider on its own servers. The user accesses the software via a browser.

2. Accounting treatment of cloud software depends on the operating model

(1) In the case of IaaS, the user company is given access by the cloud provider to its infrastructure. A time-based usage fee is incurred and this normally also includes services such as, e.g. maintenance and support. These fees constitute expenses. The software that is installed by the company on the infrastructure constitutes an acquired or an internally generated intangible asset. The presentation of this in the accounts corresponds to the accounting treatment of software that is run on proprietary systems and thus spans familiar territory.

(2) In the case of PaaS, the sole difference to the IaaS case is that no ready-made software is operated on the provider's servers; instead, software is developed there. That is why the presentation in the accounts is based on the same principles as for software development on proprietary systems.

(3) Cloud software in the case of SaaS – In accordance with accounting principles, beneficial ownership of an asset is necessary for it to be recognised. In the SaaS model, the software is usually provided for use for a limited period of time only so that, normally, beneficial ownership of the software cannot be acquired. Therefore, the respective amounts will generally have to be recognised as expenses. One-off payments would then have to be spread over the period of the expected useful life by means of a pre-paid expenses item. As the software fees in the SaaS model constitute expenses for time-limited usage these will then have to be added back again when determining trade tax (cf. details of this in the PKF Newsletter 4/2019).

Please note: However, caution is required in SaaS cases where, due to the structure of the agreement, the rules for leases would have to be adopted. Accordingly, the intangible asset would have to be recognised in the accounts of the software user (= lessee). A key criterion here is the ratio of the term of the contract to the normal period of the useful life of the asset. A contract term of 54 or more months (90% of the normal period of the useful life of the asset of five years) is usually an indication of beneficial ownership and, thus, of the capitalisation requirement for the lessee. In such a case, the acquisition costs would correspond to the present value of the payments that have to be made to the cloud provider over the term of the contract. The amortisation would be charged over the term of the contract.

3. Presentation in the accounts of customisation expenses

Besides the one-off or regular payments for the software itself, frequently, even when cloud software is used, additional costs are incurred for adapting the software to a specific operating environment (customisation). Under certain circumstances, such customisation costs would also then have to be recognised as intan-

gible assets (analogous to fixtures added by a lessee in leased premises) even if the answer to the question about beneficial ownership of the software had been negative.

Recommendation

Within the scope of cloud computing projects a number of possibilities will occur with respect to the accounting treatment, particularly in connection with company-specific adjustments. Frequently, these will have to be taken into consideration already when the contract is being formulated. Please do not hesitate to contact your PKF consultant in this respect.

LATEST REPORTS

StBin [German tax consultant] Julia Hellwig

No obligation to capitalise negligible amounts as pre-paid expenses

Outlays made before the reporting date that constitute an expense for a specific period after that date have to be recorded as pre-paid expenses. Therefore, the capitalisation of such costs is generally mandatory. To-date, in the opinion of the Federal Fiscal Court, the principle of materiality has already made it possible to disregard immaterial items in the course of the recognition and measurement process. The Baden-Wuerttemberg tax court endorsed this principle in its ruling from 2.3.2018 (case reference: 5 K 548/17) with respect to the capitalisation of pre-paid expenses. Accordingly, amounts that fall below the limit defined in Section 6(2) of the German Income Tax Act (low-value assets, currently € 800) do not have to be recorded as pre-paid expenses.

In the above-mentioned case, a sole trader had complained about the increase in his income from commercial operations due to a tax audit. He had recognised negligible expenses that had been paid in advance directly in the income statement instead of capitalising them as pre-paid expenses.

The Baden-Wuerttemberg tax court ruled in favour of the claimant. In the interests of accounting efficiency, recognising expenses on an accrual basis should "not be overdone". Moreover, the accounting principles of completeness and truthfulness are circumscribed by the principle of materiality, and for a good reason.

StBin [German tax consultant] Sabine Rössler

Disclosure requirements in the case of dealings involving foreign jurisdictions

Under Sections 138(2) and 138b of the (German) Fiscal Code, German taxpayers are required to notify their tax office of any dealings involving foreign jurisdictions. Such a notification should generally be submitted, together with the tax return, 14 months after the end of the tax period, at the very latest. The following, in particular, have to be reported: the founding, acquisition or disposal of businesses or holdings abroad. To this end, the tax authority, in the Federal Ministry of Finance circular from 21.5.2019 (case reference: IV B 5 – S 1300/07/10087), has published a new form for fulfilling the notification obligation. The old form should no longer be used. A catalogue with commercial activities of the foreign entity and an explanatory help field that can be searched have also been introduced.

PKF

AND FINALLY…

"If a financial investment is 'completely safe' you still have to ask: for whom?"

Dr Werner Schneyder, 25.1.1937 – 2.3.2019, Austrian cabaret performer, author, actor, director, boxing referee and sports commentator

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PKF Deutschland GmbH Wirtschaftsprüfungsgesellschaft

Jungfernstieg 7 | 20354 Hamburg | Tel. +49 40 35552-0 | Fax +49 (0) 40 355 52-222 | www.pkf.de

Please send any enquiries and comments to: pkf-nachrichten@pkf.de

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