PKF

Newsletter

Key Issue

Transposition of the European Anti-Tax Avoidance Directive (ATAD) has been halted for the time being

01|20

Dear Readers,

We hope that 2020 has started well for you. In the last issue of our newsletter, we heaped praise on the Federal government for presenting important tax changes at a relatively early stage. However, this was counteracted with a 109-page draft **law for the proposed transposition of the Anti-Tax Avoidance Directive (ATAD Transposition Act)** that was presented on 10.12.2019 with an invitation to submit comments within three days. In spite of this, eight umbrella organisations harshly commented on the draft point by point so that, in 2019, it was no longer possible to make any legislative changes. Nevertheless, the most important planned amendments are discussed here in the following Key Topic section because, in the course of 2020, they will indeed become law in some, more or less changed, form. It is to be hoped that the German government will reconsider, in particular, its view that countries with tax rates below 25% should be classified as low tax zones. We guess that the draft law was cobbled together hurriedly based on formulations such as the "most appropriate transfer pricing methods" should be used for the arm's length comparison.

That very **arm's length comparison** is precisely the subject of the second report, which reviews a fundamental **change to the case law** of the Federal Fiscal Court. The 1st Senate there has breached the international norm of Art. 9 OECD with a **correction** via **Section 1 of the German External Tax Relations Act** where "standard group practice" was not "at arm's length" and instead of making a pricing adjustment made a substantive one instead. As a consequence, in the case of an unsecured loan, it would not be the interest rate that was adjusted but rather the overall loss of receivables outstanding.

In view of the changes in the ATAD Transposition Act and the Federal Fiscal Court ruling on arm's length comparisons, **inter-company agreements** will, at least, have to be **reviewed**; the third article incorporates this obligation within the framework of **BEPS**. In the final article on tax we consider **hybrid financing instruments in outbound cases**. In the context of the ATAD Transposition Act these, too, will have to be reviewed.

In the Legal section we have outlined for you, first of all, the main features of a **corporate criminal law** that will be newly introduced in Germany under the working title of the "Act to Combat Corporate Crime". Moreover, the central part of this Act can be found in the draft of the so-called Corporate Sanctions Act. Finally, using a recent Federal Court of Justice ruling as a basis, we discuss the cases in which a **gift can be revoked**.

With our best wishes for a more interesting read and a successful year.

Your Team at PKF

Key Issue

Transposition of the European Anti-Tax Avoidance Directive (ATAD) has been halted for the time being

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TAX

WP/StB [German public auditor/ tax consultant] Dr. Matthias Heinrich/ Lena Wagner

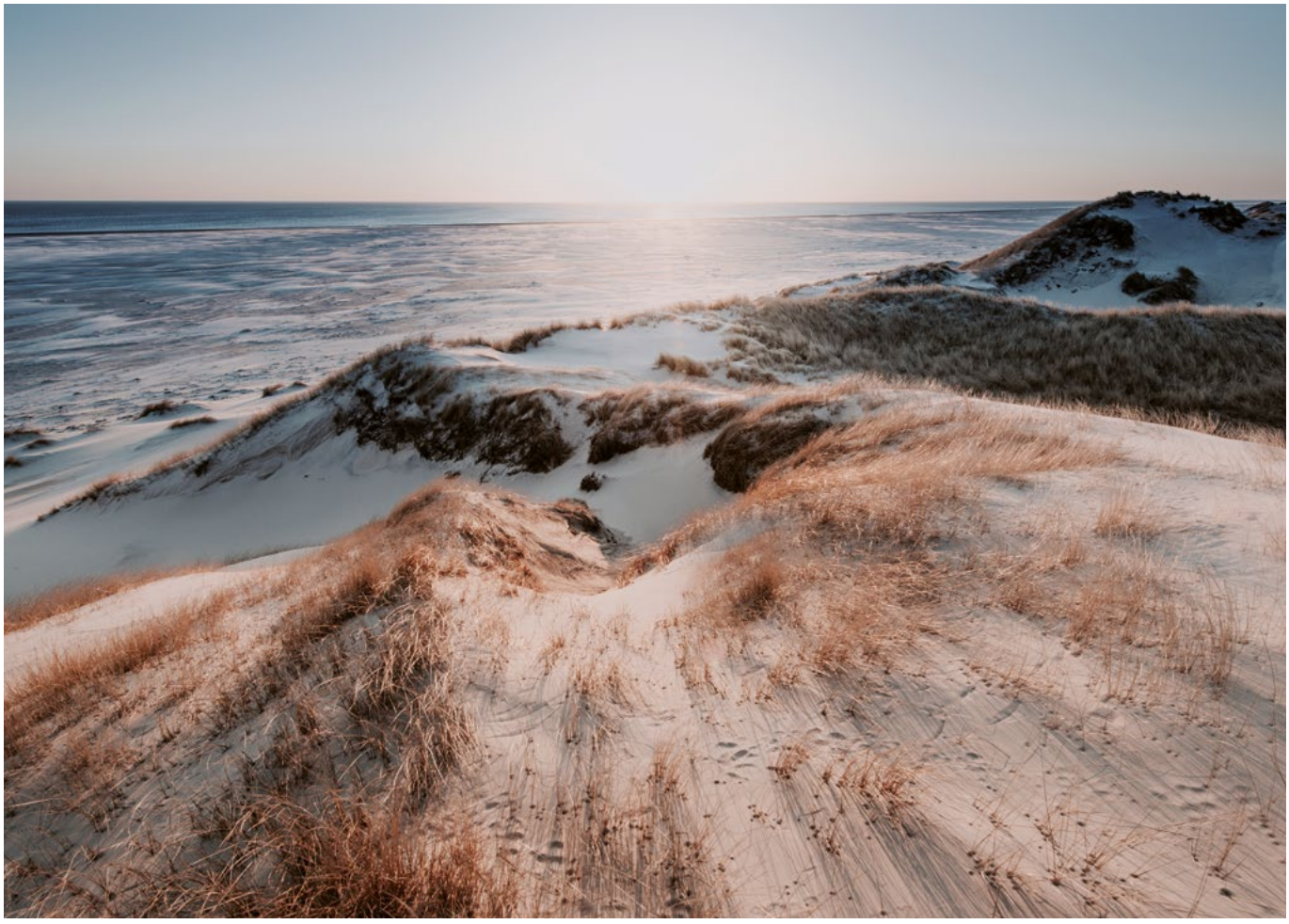
Transposition of the European Anti-Tax Avoidance Directive (ATAD) has been halted for the time being

On 10.12.2019, the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) published a draft law for the proposed transposition of the Anti-Tax Avoidance Directive (ATAD Transposition Act). This provides for the transposition of the ATAD and the reform of German CFC rules. However, the adoption of the draft law by a resolution of the German cabinet, which was scheduled for 18.12.2019, has been postponed for the time being.

1. An overview of the key points of the draft law

The draft law includes a further transposition of the Anti-Tax Avoidance Directive ((EU) Directive 2016/1164):

(1) On the one hand, the European provisions on disjunction tax and on exit tax will be transposed into German law via Art. 5 ATAD along with the provisions aimed at combating hybrid mismatches via Art. 9 and Art. 9b. The transposition of Art. 5 ATAD will occur via amendments to Sections 4, 4g, 6 and 36(5) of the German Income Tax Act – Draft (*Einkommenssteuergesetz-Entwurf, ESTG-E*) as well as via Section 12 KStG-E and Section 6 of the External Tax Relations Act – Draft (*Außensteuergesetz-Entwurf, AStG-E*). The regulations under Art. 9 and 9b will be enshrined in the new Section 4k EStG-E. The concept has been generally based on the minimum standards in the ATAD.



(2) On the other hand, the German CFC rules will be reformed and modified so that they are appropriate and provide legal certainty (Art. 7, 8 ATAD). These amendments will be transposed into Sections 7 ff. AStG-E.

2. Disjunction tax and exit tax

Art. 5 ATAD obliges member states, first of all, to disclose and then to tax hidden reserves (upon application, taxpayers can pay the tax in instalments) in the event of a cross-border transfer of business assets, the relocation of businesses, or the departure of corporations (so-called disjunction tax). In the case of a transfer of business assets to Germany, or when corporations move there, the values established for assets by a foreign state for disjunction tax purposes will be accepted if they reflect the market value (so-called conjunction).

Furthermore, the draft law provides for a tightening of exit tax rules for taxpayers with unlimited tax liability. A departure will thus trigger capital gains tax irrespective of the country to which the taxpayer is moving. In this connection, it will be possible to spread the tax consequences over a period of seven years.

3. Hybrid mismatch arrangements and incongruities in the case of residency

Under Art. 9 and 9b ATAD, Member States shall be obliged to neutralise tax advantages (e.g. double non-taxation or deducting business expenses twice) that arise as a result of diverging assessments in different countries. It is necessary to ensure that

- creditors pay tax on payments that are generally deductible as business expenses for the debtor;
- expenses in another State can only be deducted if these are matched by corresponding income inclusions;
- deductible expenses and the corresponding income inclusion result in congruence in taxation in other states.

4. Reform of the CFC rules

The reform of the CFC rules via Art. 7 and 8 ATAD includes important changes to the German CFC rules that already exist. The following measures, among others, are planned.

(1) Adjustments to the "control" criterion – Here there has been a shift away from domestic control to a shareholder-based approach. Control would thus be deemed to exist if more than half of the shares, voting rights, capital or entitlement to profits were attributable to one shareholder alone or jointly with closely related parties. The new approach to control means that the concept of transferring add-backs, hitherto regulated in Section 14 AStG, will no longer apply.

(2) Definition of 'harmful' income – To this end, the catalogue of activities that are considered to generate active income will be retained. In the case of trading and service companies, the draft law provides for the concept of "harmful participation" to be extended to taxable persons in the EU/EEA.

(3) Profit distributions will continue to be classified as active income, which means that the system established under Section 8b KStG will be taken into account. Although, profit distributions from shares that are in free float as well as those that reduce the income of the distributing corporation would be considered to be passive income. For the avoidance of double taxation an amount of reduction will be introduced for profit distributions (Section 11 AStG-E).

(4) No phase-shifted attribution – In the future, the add-back amount will accrue to the intermediary company at the end of the financial year and no longer in the logical second after it.

(5) Avoiding double taxation – In this regard, the draft law still provides only for the imputation method and the deduction method will cease to apply. Furthermore, there are no plans for offsetting against trade tax. The add-back amount will nevertheless still remain subject to trade tax.

(6) The **threshold for low taxation** will remain at 25%.

Outlook

The implementation of the draft law will not commence, as originally envisaged, on 1.1.2020 as the legislative procedure has been halted for the time being. For now, we will have to wait and see the extent to which the current draft law will still change in the course of the legislative procedure. In particular, it is still unclear whether or not the low tax threshold will be reduced – according to the draft law it is supposed to remain at the current level of 25%. Bringing it into line with the corporation tax rate of 15% is also under discussion here. We will keep you informed about the further implementation of the legislative procedure.

WP/StB [German public auditor /tax consultant] Dr. Dietrich Jacobs

Transfer pricing adjustments – New Federal Fiscal Court ruling on the blocking effect of Art. 9 of the OECD Model Tax Convention

In 2019, a change to the case law of the Federal Fiscal Court *(Bundesfinanzhof, BFH)* with respect to the extent of corrections pursuant to Section 1 of the External Tax Relations Act *(Außensteuergesetz, AStG)* created a big stir in the specialist literature. Even though the rulings have limited practical relevance – in view of the general non-tax deductibility of losses arising from the debt claims of corporations against closely related persons (or, in principle, the partial non-tax deductibility of claims of natural person) – nevertheless, we have provided an overview of them in the following section.

1. Recognition of the arm's length value (application of Section 1 AStG)

If a taxpayer's income is reduced due to a foreign business relationship with a closely related person as a result of the use of conditions that are not consistent with the arm's length principle then the income should not be recognised at the agreed conditions but rather at the arm's length value (Section 1 AStG). On 27.2.2019, the BFH stated its opinion on the application of this provision for three constellations.

(1) To begin with, the BFH, in its first ruling (case reference: I R 73/16), viewed the costs arising from the write-off on the loan of a domestic (German) parent company to its foreign subsidiary together with the costs related to the derecognition of the loan as being non-tax deductible because the loan was not characterised by the usual market terms and conditions, e.g. no collateral was provided. In this ruling, the BFH changed its previous opinion in this respect; according to its earlier decisions, a provision in a DTA equivalent to Art. 9 OECD MTC prohibited the above-mentioned application of Section 1 AStG beyond a transfer pricing adjustment (so-called "blocking effect of Art. 9 of the OECD MTC"). The BFH thus now shares the opposite view of the German fiscal authority. The reason that the BFH gave for this was that this precisely did not constitute a transfer pricing adjustment within the meaning of Art. 9 OECD; in fact, the entire loan would never have been granted by an unrelated third party without collateral; this case was about a substantive adjustment that had to be made via Section 1 AStG.

(2) In two further rulings (case references.: I R 51/17 and I R 81/17) on inter-company receivables and guarantees, the BFH highlighted that so-called group support merely expressed that within a group of companies it was usual to grant loans without collateral. Yet, group support cannot be equated with loan collateralisation. That is why it can neither replace such collateral nor exclude the possibility that a loan receivable between associated

enterprises could be of no value. What is notable here is the BFH's relativisation with respect to the question of whether or not the lack of collateral or inadequate collateral for a receivable is consistent with the arm's length principle. In the ruling mentioned under (1), the BFH was still describing such agreements simply as "not arm's length circumstances"; however, the BFH referred the latter cases back to the tax courts on the grounds that the necessary investigations had not been carried out in order to ascertain whether or not the lack of collateral for the payment claim corresponded to what an unrelated third party would have agreed (ex ante).

Interim conclusion: In summary, despite the latterly described uncertainties, new hurdles have emerged for the tax deductibility of expenses related to cross-border business relationships with closely related parties.

2. Tight limits for the Hornbach ruling

Furthermore, you should bear in mind that the BFH has placed tight limits on the application of the, basically favourable, ECJ judgement in the matter of "Hornbach" (we reported on this in the PKF Newsletter 04/2019). The contentious matters in the cases of the inter-company loans and guarantees, which were mentioned under (2), were thus not comparable with the guarantees and comfort letters that had been at issue in the ECJ's Hornbach ruling. In addition, the BFH established that for cases that involve third countries, at all events, the free movement of capital could conflict with the application of Section 1 AStG, although there could be no objection to the restriction through the German AStG due to the so-called "standstill clause". According to this clause, a restriction on the free movement of capital through national measures would (still) be allowed if these measures (like Section 1 AStG) had already existed on 31.12.1993.

Recommendation

If your objective is to enable expenses to be tax deductible, for example, the costs relating to impaired loans or other claims against closely related foreign parties (or drawdowns under a guarantee) then you should review your existing cross-border business relationships with a view to the need for amendments on the basis of the new ruling. It is advisable to structure future business relationships in accordance with the new requirements. For more details please do not hesitate to contact your PKF consultant.

Dr. Oliver Treidler

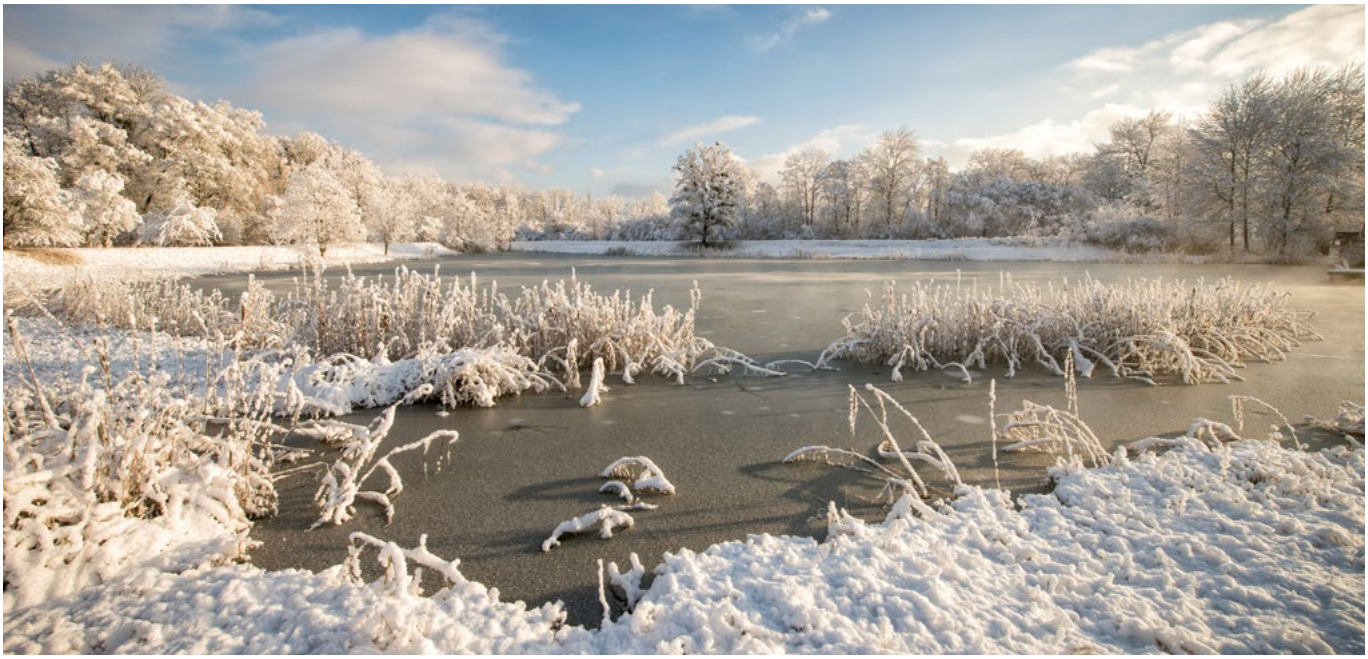
BEPS has necessitated a review of inter-company agreements

In the last few years, the OECD project to combat tax avoidance (Base Erosion and Profit Shifting, abbreviated to "BEPS"), carried out between 2013 and 2015, has caused much uncertainty in relation to transfer pricing and has allowed an already complicated subject area to become even more difficult. Now that the dust has settled and the implementation at the national level appears to have been largely completed it is worth taking a look at the main systematic changes and thinking about the important practical implications.

1. Focus on the economic substance

First of all, it can be reassuringly put on the record that the legal framework for transfer pricing was not radically changed by the BEPS project. The result of BEPS can be summarised – in a somewhat simplified way – as the "modernisation of the arm's length principle". The characteristic feature of this modernisation consists in having an even stronger focus on the issue of economic substance according to BEPS when verifying the arm's length nature of transactions. This focus on the economic substance can most evidently be understood by looking at the section on "Risks" in the OECD Guidelines from 2017 (Section D 1.2.1) – this was massively expanded. In a total of 50 paragraphs (the single biggest section of the complete guidelines), here the OECD emphasised that when the transfer pricing is being verified the relevant risks need to be identified and, subsequently, based on both the contractual allocation as well as, in particular, the actual management of economic risks.

In this case, the contractual allocation merely provides a first step in the analysis. Given that the allocation of risks frequently coincides with the entitlement to participate



in business profits (or to a share of the residual profits), the OECD has stressed that, under tax law, such an entitlement may only be granted to an enterprise that also actually has the economic possibility to exert influence on these risks (via risk management and risk mitigation) and likewise has the financial capacity to bear these risks.

While, already prior to BEPS, functional and risk analyses should have formed the core of any transfer pricing system, the importance of such analysis for the sustainability for tax purposes of such systems has been amplified once again. As regards control over risks, the OECD has now clarified, for the first time, that the operational execution of risk management can indeed be outsourced, however, the business risks always have to lie with the enterprise that also bears the contractual risks. To this end, the staff of this enterprise have to have the requisite skills and (decision-making) competencies and proof of this shall be provided upon request.

Interim conclusion: The OECD's tax policy objective, which all fiscal authorities support, is clear – to prevent business profits being shifted to "letterbox companies" via the contractual allocation of risks, in the future. For Germany, the more stringent requirements with respect to the obligations to provide documentary evidence on economic substance manifest themselves in the Ordinance on the Nature, Content and Extent of German Transfer Pricing Documentation Requirements (revised in 2017).

2. Description of economic substance in inter-company agreements

Regardless of the many discussions, BEPS should not generally be a reason for concern or for doing things for the sake of doing them. This is because, in principle, transfer pricing systems that complied with the arm's length principle prior to BEPS will remain as such within the framework of BEPS. In particular, for taxpayers whose transfer pricing is closely linked to business procedures and for whom substance is not an issue there is hardly cause for concern.

Unfortunately, BEPS nevertheless has resulted in an increased need for documentation as well as additional potential for conflict within the scope of upcoming tax audits. The respective effort (time-wise as well as financial) and risks can however be minimised to a large extent by proactively reviewing existing inter-company agreements. In particular, you should check to see if the existing agreements fully reflect, in a comprehensible way, the contractual allocation of functions and risks.

Example: Accordingly, in the case of make-to-order agreements or distributor agreements you would have to check, for example, whether or not major strategic decisions were actually – and demonstrably – being taken by the ordering party (principal). In this connection, you should likewise immediately think about how, if requested to do so, you could provide proof of the requisite substance for that at the level of the principal. Moreover, you should check to see if the contractual agreements are actually being properly implemented. If entities that perform routine functions (e.g. make-to-order manufacturers) report volatile net profits, or even (permanent) losses then this could be an indication that the contractual agreement and the economic substance are not sufficiently mutually compatible and thus, from a tax perspective, there are

risks. Frequently, selective contractual adjustments can be sufficient here in order to reduce these types of risks.

3. Particular documentation requirements for intangible assets

The rules on intangible assets have constituted a specific focus of BEPS. The above comments on the increased importance of economic substance apply here analogously. In this context it has to be noted that, in the future, legal ownership by itself will no longer be sufficient to allocate (residual) profits to a company that arise from the commercialisation of rights. Within the scope of audits, it will be necessary to demonstrate which company has assumed the economic functions (risks) in relation to the development, further enhancement, protection, preservation and commercialisation and what importance has been attributed to the respective functions for the intangible asset. The respective allocations should be properly reflected both in contract research agreements (strategic objectives, monitoring of milestones, performance-unrelated remuneration) as well as in licensing agreements (right to grant sub-licences, specifications and participation in marketing initiatives, etc.)

Recommendation

By reviewing inter-company agreements it will be possible to efficiently ensure that economic substance and the profit allocation arising from the agreements are mutually compatible. A consistent contractual basis will make a major contribution to the minimisation of tax risks in the area of transfer pricing.

WP/StB [German public auditor /tax consultant] Dr. Dietrich Jacobs

Hybrid financing instruments in international tax law – Part 1: Outbound structures

Hybrid financial instruments exhibit the typical features of both equity capital as well as debt capital. This includes, for example, subordinated loans, silent partnership holdings, profit participating loans, profit participation rights, bonds with warrants/convertible bonds and preference shares. In the following section, we present selected income tax aspects of the provision of capital in this form by domestic (German) investors to a foreign corporation (outbound financing) by analysing the taxation of the regular returns. In the next issue of the PKF Newsletter we will then consider the income tax consequences of hybrid financing instruments for a domestic (German) corporation provided by a foreign investor (inbound financing).

1. Borrowers abroad

The tax treatment for borrowers will be determined by the requirements of tax law in the foreign country. It is therefore not possible to make general statements; in fact, it is usually necessary to consider individual cases in coordination with foreign consultants. Nevertheless, for income tax purposes it is possible to make a distinction between two typical cases.

» The capital is classified, for tax purposes, as the equity of a corporation. The remuneration paid on this capital is then usually non-tax deductible but, instead, is frequently considered to be a dividend and taxed accordingly. In many cases, the foreign corporation's state will then feel entitled to levy withholding tax on such returns, although this could possibly be limited by double taxation agreements (DTA) or other rules.

» The capital is classified, for tax purposes, as debt. Notwithstanding something like special rules on the recognition of debt financing for tax purposes (e.g. so-called thin capitalisation rules), remuneration paid on this capital then generally reduces the profits of a foreign corporation. At the same time, the foreign country will frequently tax the remuneration to a German capital provider as, or like interest payments, so that the foreign country might feel entitled to levy withholding tax, which perhaps is limited by DTAs or other rules.

2. Taxation in Germany

Based on an overall consideration, the respective financing form would be assessed In accordance with the principles of German tax law. If the alternative of a partnership stake (e.g. atypical silent partnerships) is ignored then the following (put simply) applies.

» If the capital is subsequently, in Germany, classified as equity then the remuneration for lending this capital

would thus primarily be income from capital assets; depending on the circumstances of the individual case, for the investor this income could in principle, under German tax laws, be subject to a preferential form of taxation, such as for example, the partial income method, or an exemption from corporation tax and/or trade tax. However, in order to avoid the uncoordinated combined effect of foreign and domestic (German) tax laws in terms of potential under-taxation, the partial income method or an exemption from corporation tax would not apply if the remuneration at issue had reduced the profit of the corporation abroad (so-called correspondence principle).

» By contrast, if the capital constituted debt under German fiscal law then the regular returns would be considered to be interest and, depending on the individual circumstances and according to German tax regulations, would either be subject to withholding tax or "standard taxation" with income tax or corporation tax, the solidarity surcharge, church tax, if applicable, as well as trade tax.

Some German DTAs include explicit rules for the taxation of specific hybrid forms of financing. However, beyond the scope of application of these special rules, at the latest, in some cases, there is still considerable legal uncertainty as regards the application of DTAs. For example, the Nuremberg tax court, in a ruling from 30.1.2018 (case reference: 1 K 655/16, Tax Court Decisions in 2019 p. 214) classified the returns from special preference shares of a US American company as interest not only according to domestic (German) assessments but likewise under the USA DTA; nevertheless, it itself admitted that a Federal Fiscal Court ruling would be needed to achieve uniformity of taxation. The outcome of the appeal proceedings (case reference: I R 12/18) is therefore highly anticipated.

Recommendation

The business appeal of hybrid forms of financing frequently lies in the possibilities arising from the flexible structure that can thus be adapted to individual requirements. However, the optimal use of such financing instruments in cross-border constellations is usually complicated in terms of tax and, in some cases, is subject to legal uncertainty. In the past, it was possible to generate, to some extent, low-taxed income using cross-border hybrid financing instruments. However, these possibilities were already previously limited by the correspondence principle and the planned changes in the ATAD Transposition Act (cf. Key Issue report in this newsletter) are likely to diminish them considerably once again.

LEGAL

RA [German lawyer] Dr. Franz Schulte / Anja Sackmann

Introduction of corporate criminal law – What companies can expect in the future

Up to now, while it has been possible to impose fines against companies, nevertheless, only individual members of companies could be liable to prosecution. In this connection, the Federal Ministry of Justice presented a draft of the "Act to Combat Corporate Crime", on 15.8.2019. The core element here is the Corporate Sanctions Act (Verbandssanktionengesetz-Entwurf, VerSanG-E), which we discuss in the following section.

1. Current legal situation

Up to now, there has been not been consistent punishment for corporate crimes. Prosecution has been left to the discretion of the competent authorities. Currently, criminal offences may be punished by the imposition of a fine of up to € 10 million, which is regarded as being disproportionately low in relation to large corporations. In addition, up to now, there have also been no incentives that could provide legal certainty for implementing compliance measures or for conducting internal investigations, something that has likewise been criticised in some cases.

2. Key points of the draft law

2.1 The principle of legality

According to the draft of the VerSanG, the sanctioning of organisations would be subject to the so-called legality

principle. Accordingly, if initial suspicion exists then the competent authorities would be obliged to initiate a preliminary investigation. The aim of this is to ensure that prevailing law is applied evenly and consistently.

2.2 Sanctions for organisations

The addressees of the Act are organisations in the general sense, thus for instance, legal persons under public or private law (e.g. an AG, joint stock company, or a GmbH, German limited company), associations and partnerships (an OHG, German ordinary partnership, or a KG, German limited partnership). Sanctions would then be imposed on organisations if the duties of the organisations had been breached or (possible) enrichment of the organisation had occurred. All categories of offence under German criminal law would qualify as offences by organisations, e.g. crimes against property, tax offences, environmental offences, or criminal acts against free competition.

The above-mentioned offences could be committed by leaders of organisations. Besides leaders in the narrow sense – e.g., managing directors, board members or shareholders/partners authorised to represent a company – this also includes other persons to whom management authority has been delegated. Moreover, a breach of supervisory and organisation duties has also been included in the catalogue of potential offences by leaders. In this way, incentives should be created for companies to set up compliance management systems (CMS).

2.3 Types of sanctions

Possible sanctions for organisations include fines for organisations, warnings and the dissolution of an organisation.

In future, fines will be differentiated and based on revenues. For organisations with commercial business activities and average annual revenues of more than 100 million, the maximum penalty would be 10% of average annual worldwide revenues. Estimating annual revenues will be allowed. In especially difficult cases the organisation could even be dissolved and a fine imposed on the organisation.

Please note: In accordance with the principle of 'naming and shaming' the sentences will be made public. A sanctions register will be set up for this purpose.

2.4 A functioning compliance system

A key objective of the draft law is supposed to be the promotion of compliance initiatives. In the future, setting up a functioning CMS will be regarded as being an almost obligatory precautionary measure to help organisations avoid committing offences.

Please note: In particular, CMS would be regarded positively when determining sanctions. Ultimately, setting up such systems could in effect be enforced through a requirement by a court.

2.5 Internal investigations

A softening of sanctions on organisations could be brought about by conducting an internal investigation of the organisation. The maximum potential amount of the sanction could thus be reduced by half. The dissolution of the organisation would then not be possible and public notification of the sentence would be ruled out.

Such internal investigations of organisations that reduce

the severity of the punishment have to contribute considerably to clarifying the facts and may not be conducted by the defence lawyer for the company or by the accused. The organisation would have to cooperate fully with the prosecuting authorities. What exactly this would mean is not yet clear. Reports about the internal investigations and all the important documents obtained would have to be submitted and compliance with the principles of a fair trial would have to be observed.

3. Particularities in the context of the future application of the law

The introduction of the so-called legality principle (see above section 2.1) will, in future, create an obligation to investigate an initial case of suspicion and, if an offence has been committed by an organisation, to impose a sanction on it.

Offences committed by an organisation do not have to fall under the German criminal statutes. Consequently, a domestic (German) organisation can also be sanctioned for an offence in a foreign country if the crime would have been punishable under the application of German criminal law.

Anyone acquiring the essential assets of an organisation could be held liable for the sanctions on the organisation incurred by the legal predecessor. In M&A transactions, in particular, the additional risk stemming from any liability for deficiency would have to be taken into account. This will have to be borne in mind when carrying out due diligence checks.

The previous legal provisions of the Administrative Offences Act *(Gesetz über Ordnungswidrigkeiten, OWiG)* relating to offences committed by organisations (Section 30, Section 130 OWiG) will continue to exist.

Recommendation

Companies should concern themselves, in particular, with setting up a functioning CMS in order to minimise the risk of criminal acts and to be able to get to the bottom of breaches of duty that have been committed. The lack of a precautionary system, in practice, will be regarded as a shortcoming – a greater one than previously.

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

"Can you take back a gift?" – What you need to know about the revocation of gifts

Passing on assets to the next generation by way of a lifetime transfer (anticipated inheritance) is widely practised. The question is however what happens if, subsequently, things do not turn out as was assumed when the assets were gifted.

1. The case in question – Gifting for the purpose of property finance

This situation is likely to be one that is more common. The parents had given funds to their daughter and the daughter's life partner of many years in the amount of around € 100k. This was used for co-financing a residential property that had been jointly acquired by the beneficiaries. Less than two years after the gifting had occurred the couple separated. Thereafter, the parents sought to reclaim from the former life partner his respective share of the gift and succeeded in doing so – in the final instance, the Federal Court of Justice ruled in their favour (judgement from 18.6.2019, case reference: X R 107/16).

2. Does the basis of a transaction cease to exist in the case of a separation?

The court did nevertheless clarify that a donor basically bears the risk that the future lifestyle of a beneficiary and what s/he does with the gift will not conform to the expectations of the donor. However, the case should be judged differently if the donor's expectations had discernibly become the transactional basis for the gift. If this ceases to exist then there is justification for cancelling the transaction.

Gifting property ownership, or amounts of money intended for this purpose, to a child and his/her partner is usually borne by the expectation that, in any case, the property will be used jointly as a family home by the beneficiaries for a certain amount of time. That was also the court's assessment of the issue in the case in question. The parents' expectations became the transactional basis for the gift and this as eliminated by the separation that occurred

shortly afterwards. The conditions for cancelling a transaction had thus been satisfied.

Please note: On the question of the period of time for which a relationship has to last in order to be able to deny that the basis of a transaction has ceased to exist, the court implied that, in this respect, it wished to base its decision on case law pertaining to marriages of short duration under maintenance law. Accordingly, periods of up to two years would always be viewed as being of (too) short duration and a period of more than three years always as long enough.

3. Legal rights to demand the return of a gift

Apart from the basis of a transaction ceasing to exist, there are two further regulated possibilities for demanding that a gift be returned.

- Impoverishment of the donor (Section 528 German Civil Code (Bürgerliches Gesetzbuch, BGB) – A donor, following the gifting, finds him/herself in a position where s/he is unable to reasonably provide for him/herself or to meet the maintenance obligation incumbent upon him/her by law.

- Gross ingratitude of the beneficiary (Section 530 BGB) in the form of serious wrongs done to the donor or a close relative of the donor, e.g., physical ill treatment or serious insults.

4. Recommendations: Set out the contractual rights to demand the return of a gift...

To counter the uncertainty of whether or not the rights to demand the return of a gift would be pertinent it would be advisable, in the gift agreement, to lay down specific criteria for demanding the return of the gift in special circumstances. Typical cases could be, e.g.,

- beneficiary dies before the donor;
- insolvency of the beneficiary;
- beneficiary needs a carer;
- beneficiary sells the gift without the consent of the donor.

... protect against tax risks

Sometimes people also forget to protect against the tax risks of gifting that arise from the rights to demand the return of a gift. This is particularly the case where business assets are gifted. The parties involved usually assume that gift tax is not applicable here because of gift tax exemptions. However, the conditions for exemptions are complicated and include a number of risks, e.g., with respect to non-operating assets that are harmful from a tax point of view. It is therefore advisable, as a precaution, to likewise provide for the possibility to demand the return of a gift if, contrary to expectations, gift tax is triggered. If the right were exercised then gift tax would expire retroactively. Moreover, re-transferring would not constitute gifting again.

LATEST REPORTS

"Lost" advance payment – Input tax deduction requires precise definition of the contractual item

Businesses are able to deduct the input tax from advance payments if they have been provided with a proper invoice for the advance payment where the VAT charged is shown separately and the payment has actually been made. Moreover, according to a ruling of the Federal Fiscal Court (Bundesfinanzhof, BFH) from 17.7.2019 (case reference: V R 9/19), for an input tax deduction to be possible the item that is to be subsequently supplied has to be precisely defined from the perspective of the business that is making the advance payment. Furthermore, from the viewpoint of this business, the supply has to appear to be sufficiently certain. The BFH took this requirement from ECJ case law. In the case in question, an investor had ordered a block-type thermal power station from a GmbH (a German limited company) and had made an advance payment from which it deducted the input tax. However, the block-type thermal power station was not delivered subsequently because the GmbH went bankrupt. The advance payment made by the investor was completely lost.

In the case in question, the BFH first obtained a preliminary ruling from the ECJ and, on this basis, allowed the investor to deduct the input tax. The crucial point here was that when the advance payment was made the contractual item had been precisely defined and the investor was able to presume that it would also be supplied to him. By con-

trast, for the BFH it was unimportant that, from the outset, the GmbH had not at all wanted to provide the service.

Please note: The input tax deduction can be made for the VAT accounting period in which both requirements have been satisfied for the first time. In the opinion of the court, the investor likewise did not have to subsequently adjust his input tax deduction, as is necessary, e.g., where purchases have been cancelled or price reductions obtained. This is because, for this it would have been necessary for the supplier to refund the advance payment; however, this did not happen in the case in question.

Prize money – When does the fiscal authority have to have a share?

Anyone who receives prize money should quickly clarify the issue of the tax liability situation. Whether or not prize money is subject to income tax will be determined by the type of prize money. It will remain tax-exempt if the underlying prize recognises a lifetime achievement or an entire œuvre, honours the personality of the prize winner, distinguishes a personal attitude or singles out a role model function. This includes, for example, Nobel prizes because these are awarded for the outstanding personality of the prizewinner and his/her groundbreaking overall achievement.

By contrast, prize money that is related, in economic terms, to the activity carried out by the person who has been distinguished will be liable to tax. This will be the case where, in economic terms, the presentation of the award has the nature of a performance-related remuneration and is both the objective and consequence of the activity that is carried out (e.g. design concept competition for architects).

Likewise, university staff who, for example, are distinguished with academic awards have to declare the prize money under remuneration because, in this case, there is a clear connection to the professional research activities at the university. Moreover, an economic connection exists if the award promotes professional activities or demonstrably generates additional income.

RAin [German lawyer] Maha Steinfeld / Anja Sackmann

Social security – Thresholds for 2020

Parity financing of health insurance contributions was reintroduced in 2019 and will likewise continue for 2020. Accordingly, employees and employers each pay half towards the contribution to the statutory health insurance providers. In the case of trainees who receive remuneration of up to € 350 monthly, the employer solely pays the contributions. If this limit is exceeded through a one-off payment such as, e.g., a Christmas bonus or a holiday bonus then this relief ceases to apply. Employees and employers then share the payment of the contributions equally.

The average supplementary contribution to the statutory health insurance providers for 2020 has gone up to 1.1% while the contributions to unemployment insurance have been reduced by 0.1%. For the current social security values please refer to the overview that follows on page 15.

Furthermore, it should be noted that the minimum wage was increased as of 1.1.2020 from € 9.19 to € 9.35. As a result, the monthly maximum working hours for mini jobbers has been reduced to 48 hours/monthly.

In the course of year-end reporting activities in personnel departments, further contributions will have to be taken into account. The allocation to social security contributions for artists has remained at 4.2%. We would like to remind you that the report on the fees paid, in 2019, that are liable to social security contributions has to be submitted by 31.3.2020. This report forms the basis of the contribution assessment that, once it has been issued, results in a payment obligation that will be in addition to any prepayments that have possibly been determined.

Likewise, information relating to and the payment of the countervailing charge for not employing severely handicapped people in 2019 have to be submitted by 31.3.2020. The salary and wages verification statement for the statutory trade association for health and safety at work and employer liability insurance (*Berufsgenossenschaft*) has to be submitted electronically to the competent Berufsgenossenschaft by 16.2.2020. The contributions have to be paid once the contribution assessment has been issued.

Key Social Insurance Values and Tax Dates for 2020

All data in EUR and monthly, except where otherwise specified.

Type of Contribution	Old Federal States	New Federal States
Income threshold for compulsory insurance in the statutory health insurance scheme		
A) General, annual*	62,550.00	62,550.00
B) For those with private health insurance on 31.12.2002 due to breaching the 2002 threshold **	56,250.00	56,250.00
Contribution assessment ceiling *(Beitragsbemessungsgrenze)*		
Statutory Pension Insurance and Unemployment Insurance monthly	6,900.00	6,450.00
annual	82,800.00	77,400.00
Health Insurance and Long-term care Insurance monthly	4,687.50	4,687.50
annual	56,250.00	56,250.00
Contribution Rates		
Statutory Pension Insurance (of which employer and employee pay ½ each)	18.6 %	18.6 %
Unemployment Insurance (of which employer and employee pay ½ each)	2.4 %	2.4 %
Health Insurance + supplementary contribution set by individual health insurers (of which employer and employee pay ½ each)	14.6 %	14.6 %
Average supplementary contribution	1.1 %	1.1 %
Long-term Care Insurance for people with children (of which employer and employee pay ½ each)***	3.05 %	3.05 %
for childless people	3.30 %	3.30 %
Max. employer-paid subsidy voluntary statutory health insurance	342.19 + half of the individual supplementary contribution	342.19 + half of the individual supplementary contribution
Max. employer-paid subsidy for private health insurance**	367.97	367.97
Max. employer-paid subsidy long-term care insurance (apart from Saxony)	71.48	71.48
long-term care insurance (only Saxony)		48.05
Reference values for statutory pension insurance/ unemployment insurance monthly	3,185.00	3,010.00
annual	38,220.00	36,120.00

* Section 6(6) of Volume V of the German Social Security Code
** Section 6(7) of Volume V of the German Social Security Code
*** For employees, in addition, there could potentially be a surcharge on the contribution for those who are childless (0.25%) that they would have to bear alone and for which they would receive no subsidy. In Saxony the contribution costs are borne differently: employer 1.025 % and employee 2.025 % (potentially plus 0.25 % surcharge on the contribution for the childless).
**** the average supplementary contribution of 0.9 % is included in this contribution

Mini Jobs

Type of Contribution	Amount
Contributions for low-wage employees (mini jobs) Employer's flat-rate contribution	
Health insurance	13 %
Statutory pension insurance	15 %
Flat-rate tax (including church tax and the solidarity surcharge)	2 %
Remuneration threshold for marginal jobs (Mini Jobs)	450.00
Minimum basis for assessment of statutory pension insurance for marginal employees	175.00
Minimum contribution/month (175 € x 18,6 %)	32.55
Sliding scale (until 06.2019)	450.01 bis 850.00
Transition range (from 01.07.2019)	450.01 bis 1,300.00
Low earners threshold for trainees (social security contributions are borne by employers alone)	325.00
Maximum contribution for direct insurance schemes annually 8 % of the tax-exempt contribution assessment ceiling for pension insurance thereof max. exempt from social security charge	6,624.00 3,312.00
Minimum payment amount for the obligation to make contributions for pension benefits in health insurance and long-term care insurance schemes	159.25
Allocation to statutory insolvency insurance	0.06 %
Allocation to social security contributions for artists	4.2 %

Reference values for benefits in kind in 2020

Meal allowance in EUR
Employees and adult family members

	Breakfast	Lunch	Dinner	Meals overall
monthly	54.00	102.00	102.00	258.00
daily	**1.80**	**3.40**	**3.40**	**8.60**

Accommodation allowance in EUR

(monthly)	235.00
per calendar day	**7.83**

Due Dates for Social Security

Month	Filing date for the contribution statement	Payment due date
January 2020	27.01.2020	29.01.2020
February 2020	24.02.2020	26.02.2020
March 2020	25.03.2020	27.03.2020

AND FINALLY...

“The unity of Europe was the dream of a few.
It became the hope of many.
Today it is a necessity for us all.”

Konrad Adenauer (5.1.1876 –19.4.1967),
first German Federal Chancellor 1949 –1963.

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