PKF

Newsletter

Coronavirus Special:
CARES Act, home offices, legal and accounting issues as well as eurobonds

05|20

Dear Readers,

This newsletter issue is dedicated almost entirely to the coronavirus crisis. Over the last few weeks you have already been able to receive or access the continuous information provided by PKF about tax relief, the short-time working allowance and the financing available from the KfW [a German government-owned development bank]. Now, in an extra "**Coronavirus Special**" section, we have worked through the issues where there has not been quite so much focus.

First of all, we take a look at the two trillion-dollar **US aid package known as the CARES Act.** The programmes put together under this label seem to be more extensive then any other form of state aid, in particular, in view of the loans that will not have to be repaid. This is followed by two articles relating to **home offices** that answer the question: which costs for a **home office** are deductible and if a **company car** is no longer being used for journeys to an (external) office is there still a non-cash benefit? Subsequently, we focus on two legal questions: what simplifications have been enacted, in particular, for **shareholders' resolutions** and who may **withhold rental payments** and when? Thereafter, we discuss the **accounting implications of the coronavirus** for the financial year ending 31.12.2019. While it was only after that date that the virus started spreading further, nevertheless, an account of the effects will be required in the so-called supplementary report as well as in the reports on risk and on expected developments that form part of the management report. Finally, we contrast **eurobonds** with other financing arrangements for eurozone countries with poor creditworthiness and outline the advantages and disadvantages associated with this specific instrument.

Next up, in the tax section, we have two reports each constituting the first of a two-part series, which we wish to continue in the next newsletter issue. The first one concerns **changes in transfer pricing rules**. Within the scope of the so-called ATAD Transposition Act, sweeping changes are being made to transfer pricing rules in Germany. Here we highlight, especially, the obligation to submit documentation electronically for the first year, 2021, for revenue thresholds that have been reduced – you should focus on these issues now already. Our second report deals with important **aspects of the German Research Allowance Act** with the intention of making it simpler for you to check if and to what extent such funding is available as an option for you.

With the illustrating photos in our newsletter we would like to remind you just how beautiful our country is and provide suggestions in the event that this year – if at all – we are able to go somewhere in Germany on holiday. After featuring Thuringia, Saxony and Saxony-Anhalt in the last newsletter issue, for the following sections we have selected impressions from the Lake Constance-Black Forest region.

Take care.

Your Team at PKF

Lindau, Lake Constance

Coronavirus Special

CARES Act, home offices, legal and accounting issues as well as eurobonds

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CORONA VIRUS SPECIAL

WP/StB [German public auditor/tax consultant] Daniel Scheffbuch WP/StB/RA [German public auditor/tax consultant/lawyer] /CPA Ralf Rüdenburg (NYC)

The CARES Act – The US rescue package

The USA ushered in the "Coronavirus Aid, Relief and Economic Security Act" (CARES Act) on 27.3.2020. The aid package comprises a volume of approx. two trillion dollars (in the meanwhile, a further USD 500 bn has been added) and is intended to mitigate the economic consequences of the coronavirus crisis. In the following section you will find an overview of the general tax changes and the specific relief available to employers as laid down in the CARES Act.

1. General tax amending provisions

1.1 Far reaching loss carryback

The limitation for loss deductions has been temporarily repealed. Losses from assessment periods starting after 31.12.2017 and before 1.1.2020 can be carried back for five years. As a result, tax payments from the period prior to the tax reform can be refunded – these had been based on a considerably higher tax rate.

1.2. Refunds of tax credits

Companies with alternative minimum tax credits that were unused prior to the tax reform can offset these immediately against taxes for the assessment periods commencing 2018 and 2019. If the value of the alternative minimum tax credits is greater than the tax liability then, upon application, the respective amount will be paid out by the fiscal authorities.

1.3 Raising the interest barrier

The barrier for the deductible amount of interest expense will be raised from 30% of EBITDA to 50% for the assessment periods commencing in 2019 and 2020. Furthermore, the rules also provide the option of using the EBITDA applied in 2019 also to calculate the interest barrier for assessment periods commencing in 2020.

Mainau Island, Lake Constance

Please note: This option will benefit the presumably large number of businesses whose EBITDA in 2020 will be lower than the one reported for 2019.

1.4 Increased charitable deductions

For corporations, the limit on the deduction for charitable contributions has gone up from 10% to 25% and for private individuals from 50% to 100% of adjusted gross income, for which an additional calculation has to be provided.

1.5 Early distributions from existing annuity and retirement savings plans

For withdrawals of up to USD 100,000 the generally applicable ten percent tax penalty will not apply. Furthermore, the income tax associated with such distributions may be paid over a three-year period. If the withdrawn funds are recontributed within the next three years then the distributions that were made will not be taxed.

Please note: Relaxed rules also apply to loans taken from specific retirement savings plans.

1.6 Measures for private individuals

Besides increasing the amount of deductible charitable contributions as well as the analogous relief on restrictions for loss deductions, one-off direct payments are also planned. US citizens who have a social security number will receive a one-off payment of USD 1,200 if they are individual taxpayers, while joint taxpayers will receive USD 2,400. Moreover, there is also an entitlement to an additional payment in the amount of of USD 500 for each child.

Please note: The one-off payments will be reduced or will not be distributed to those who exceed certain income thresholds.

2. Specific relief for employers

2.1 Paycheck Protection Program (PPP)

For many companies as well as the self-employed the most interesting element of the government aid package is likely to be the so-called Paycheck Protection Program (PPP). As a consequence of this it should be possible to ensure that employees continue to be paid wages and salaries and, ultimately, to avoid mass redundancies and insolvencies. As part of this measure, companies may, under certain conditions, apply for a loan of up to USD 10 million in order to be able to continue paying salaries, health care benefits, interest on real estate loans, rent, utilities and interest on other debt obligations. The exact amount of the loan will depend, in particular, on the total amount of payroll expenses.

A special feature of the loan is that under certain conditions it may be forgiven, if, among other things, employees continue to be employed or paid, at least until the end of June, without a major reduction in their salaries. Loans that cannot be forgiven will have to be repaid over a period of up to 10 years at a reduced rate of interest. Loan amounts that have been forgiven should not be included in the calculation of taxable income. In that case, according to the applicable rules, the corresponding expenses would not be deductible either.

Please note: At present, there is no comment from the fiscal authorities on the question of the extent to which, in view of the current situation, exceptions will be made to the application of the rules on the deduction of the corresponding expenses.

2.2 Employment Retention Credit (ERP)

Employers whose businesses fully or partially suspended operations due to a governmental order, in the course of the coronavirus crisis, and who refrained from laying off their employees can receive a refundable payroll tax credit equal to 50% of the wages and salaries that were paid to these employees during the coronavirus crisis. The tax credit will be granted for a maximum amount of wages and salaries paid of USD 10,000 per employee.

Please note: This programme will not available if the company has availed itself of a PPP loan (see section 2.1 above) and the loan has been issued.

2.3 Payroll Tax Deferral (PTD)

The PTD provisions allow employers to defer the payment of social security contributions that fall due between 27.3.2020 and 31.12.2020. 50% of the contributions for this period will fall due on 31.12.2021. The remaining amount will have to be paid on 31.12.2022. There is no requirement to provide documentary evidence that the company has been directly affected by the coronavirus pandemic.

Please note: This programme would likewise not be available if the company has availed itself of a PPP loan (see section 2.1 above) and the loan has been issued.

StBin [German tax consultant] Anna-Marie Ruesch

A temporary home office – Strict rules for the deduction of costs for tax purposes

On account of the coronavirus pandemic, many people are currently newly working from home (home office). The question that arises is the extent to which the costs – in the form of a share of the rent, energy, etc. – for the room that is used for this purpose (a so-called home office) may be deducted against income tax.

1. Basic principles

If no other workspace is available for business or professional activities then the expenses associated with a home office up to an amount of € 1,250 may generally be offset against tax as work-related costs or business expenses. If the home office constitutes the professional hub then even the limit on this amount ceases to apply.

A home office may only be taken into account for tax purposes if it is separated from the other rooms in the rest of the living area. Claiming a deduction for a share of the rent would thus not be possible, for example, for a "work corner".

2. Impact of the coronavirus crisis

During the coronavirus pandemic many companies have sent their staff home and asked them to work from there; even the self-employed and small businesses are increasingly moving their professional activities to their own homes. Consequently, if no other workspaces were available (at least temporarily) for employees then a deduction of the above-mentioned costs would be possible. However, specific evidence of the lack of any other workspace would have to be presented to the local tax office, e.g., by means of a certifying statement from the employer.

Furthermore, the taxpayer bears the burden of proving that the home office was used exclusively, or almost exclusively for business or professional purposes. However, a room that has been set up like an office but which, to a considerable extent, is also used for other purposes (e.g. as an ironing room) is, according to the view taken in case-law, not a home office. Although, private joint use of less than 10 % is not deemed to be detrimental from a tax point of view.

To avoid the associated disputes with the local tax office, it is therefore advisable, if necessary, to rearrange or clear out the room and to document this accordingly with photographs at the beginning and end of the period of use as a home office and to rule out an alternative use for the room.

Recommendation

The costs for the home office may be deducted on a tax return under the above-mentioned conditions. If the local tax office does not include the costs on account of a lack of documentary evidence of business or professional use then, with reference to the exceptional circumstances during the coronavirus pandemic, you should consider lodging an appeal and apply for a measure to be taken on equitable principles.

RAin [German lawyer] Maha Steinfeld

The home office and company car taxation

While working from home, in the current situation, no regular journeys are generally being made to the employing company's main office. In this case, applying the blanket 0.03% rule to journeys between the home and the primary workplace could be disadvantageous for employees. Therefore, the question that arises is: are there "better" alternatives?

1. Applying the 0.03% rule

Determining the taxable value of journeys between the home and the primary workplace is basically done, on a calendar-monthly basis, by multiplying 0.03% of the list price by each kilometre of the distance between the home and the primary workplace (Section 8(2) clause 3 of the


Wasserburg on Lake Constance

Income Tax Act *[Einkommenssteuergesetz, EStG]*; under this alternative, the basis is equal to a blanket number of 15 days for each calendar month. This will also apply even if the motor vehicle is only occasionally made available to the employee. In the case of working from home, this can result in having to pay tax on an extra amount for 15 days/month even though very few or no journeys to the employer's main office are happening.

2. A possible solution – no primary workplace

A primary workplace is the fixed business premises of an employer, of an associated company or of a third party designated by the employer that has been permanently assigned to the employee (cf. Section 9(4) EStG). If

- no primary workplace has been assigned under either public service law or labour law and,
- in addition, none of the fixed business premises visited by the employee meet the legal criteria for primary workplaces

then the employee will not have such a primary workplace. In this case, the 0.03% rule ceases to apply and the employee does not have to pay tax on the extra amount. Public service law or labour law provisions as well as the agreements and instructions that implement these determine the assignment of primary workplaces.

Advice: Any existing provisions in employment agreements that should not apply during a period of working from home should be amended and adjusted accordingly. However, on the basis of the legal criteria, even if no primary workplace has been contractually assigned then, during deployment from a home office, if the employee is supposed to work for (at least) two full working days during each working week, or for one third of his/her agreed, regular working time at an employer's business premises then these shall constitute the primary workplace.

3. Individual assessment (0.002% rule)

If there is a primary workplace but the employee does not drive to it every working day then an individual assessment, prepared on the basis of records and covering only the actual number of days at the employer's main office, may be used.

An individual assessment of the journeys between the home and the primary workplace using 0.002 % of the list price for each kilometre of distance is possible for no longer than 180 days for each calendar year if the following conditions, in particular, are met:

- Every calendar month, the employee has to provide the employer with a written statement in relation to the vehicle specifying on which days (with the dates) s/he had actually used the business motor vehicle for journeys between the home and the primary workplace.
- The employer has to retain these employee statements as records for the payroll accounts.

Advice

The method may not be changed during the calendar year. Employees, in the context of their income tax assessments, are however not bound by the 0.03% rule used in the payroll tax deduction system and are able to switch to using individual assessments for the entire calendar year (for the legal situation with respect to the payroll tax treatment of company motor vehicles provided to employees for their use please see the Federal Ministry of Finance circular, from 4.4.2018, case reference: IV C 5 – S 2334/18/10001).

RA [German lawyer] Sven Hoischen

GmbH (private limited company) shareholders' meetings and resolutions – Exemptions in 2020

In the context of the coronavirus crisis, the COVID-19 Mitigation Act was newly introduced, on 27.3.2020. The Act includes simplifications with respect to conducting shareholders' meetings and the passing of the resolutions of a GmbH in the course of 2020.

1. Starting position – legal principles up to now

The resolutions of the shareholders of a GmbH are passed at meetings. Physical presence is generally required. According to the German Limited Liability Companies Act, physical meetings do not have to take place if all shareholders have declared in writing that they agree with the resolution to be taken or agree to vote in writing. The company agreement of a GmbH may differ from statutory provisions and establish prerequisites for assembling and passing resolutions at shareholders' meetings outside of a session with individuals who are physically present.

2. Simplifications under the COVID-19 Mitigation Act

(1) Passing resolutions – Based on the new statutory provisions, the resolutions of the shareholders can be passed in writing or voted on in writing even without the agreement of all the shareholders. Consequently, the statutory requirement to have the approval of all the shareholders for passing a resolution in writing does not apply. This is true for both voting in writing as well as written resolutions.

Interim conclusion – It is now also possible to pass resolutions, even without the approval of all the shareholders and without the respective provisions in the articles of association, by way of a circulation procedure or by e-mail so long as approval is given by a simple majority or other type of majority provided for in the articles of association.

(2) Resolutions that require notarisation have been excluded – The simplifications described above do not apply to resolutions that require notarisation. Such reso-

Kaiserstuhl hills in the Breisgau region

lutions have to be passed at an assembly, before a notary, that people attend in person or through voting that is separately certified by a notary.

(3) Specials rules for the registration of reorganisations – For mergers and reorganisations in 2020, a cut-off date for the preparation of the final balance sheet of the transferring legal entity that is twelve months before the date of registration with the commercial register court will be considered acceptable. (Re)structurings will be able to take place later in 2020 as a result of the extension of the eight-month deadline – as provided for under Section 17(2) of the German Reorganisation Act – to twelve months.

Advice

Irrespective of the provisions of the COVID-19 Mitigation Act, the other requirements with respect to majorities for passing resolutions – such as, for example, the regulations provided for in the articles of association relating to the deadline for invitations and the presence of a quorum – continue to apply. If you have any questions with respect to conducting shareholders' meetings and the passing of resolutions we would be pleased to advise you.

RA [German lawyer] Philipp Ortmann

Obligations to pay rent during the crisis

In response to the COVID-19 pandemic, the German government has taken various measures to support businesses burdened with liquidity shortages. One such measure is the temporary exclusion of the right to terminate a rental contract in the event that the tenant is unable to pay the rent. Besides residential tenants, the government is also providing relief to commercial tenants. While this measure will enhance the tenant's liquidity, nevertheless, it will be offset by a shortfall in liquidity for the landlord. Withholding rent moreover is an option that also harbours risks tenants.

1. General obligation to continue paying rent

For many businesses, monthly lease payments constitute a significant share of fixed costs. At the same time, the landlords in turn possibly rely on the monthly incoming payments to cover running costs or to support themselves. The question that arises is whether or not, during the coronavirus crisis, tenants are even still obliged to pay rent.

In principle, the tenant bears the risk of being able to make profitable use of the rented premises. By contrast, the landlord bears the risk that the rented premises are fit for their intended purpose. According to this basic legal decision it will very often be the case that, despite the coronavirus crisis, the tenant will have to continue paying the rent. Some argue that, because of the exceptional situation, tenants are nevertheless entitled to reduce the rent or even withhold it completely.

2. Protection for tenants against contract termination

While the courts have not yet clarified the legal situation and, in individual cases, particularities will have to be complied with because of specific agreements in rental contracts, nevertheless, in the context of the new rules, the German government appears to have assumed that the obligation to pay rent will continue to exist. In order to protect tenants – including commercial tenants – from losing their rented properties on account of the COVID-19 pandemic, the German government has put in place a temporary suspension of a landlord's right to contractual termination.

Under the legal rules, the landlord may not terminate the rental contract solely on the grounds that the tenant has not make any rental payments for the months of April to June 2020. However, the precondition for this is that the tenant is experiencing payment difficulties and these have been directly caused by the COVID-19 pandemic. The tenant has to be able to credibly demonstrate these circumstances to the landlord if necessary.

Recommendations: Tenants should therefore clearly document the effects of the pandemic on their businesses. In cases of doubt, landlords should request documentary evidence of the tenant's payment difficulties and of the effects of the COVID-19 pandemic on the tenant's business.

3. The obligation to pay rent can trigger penalty interest on arrears

Furthermore, the parties to a rental agreement should be aware that under the new Act the obligation to pay rent

does not cease to apply. Tenants will have to pay the rent to the landlord later on. If the subsequent payment is not made by 30.6.2022 then the landlord could potentially terminate the tenant's lease.

Another consequence of the still existing obligation to pay is that, despite the suspension of the landlord's right to contractual termination, the tenant will be deemed to have defaulted on his/her rental payments. In this respect, the landlord would be entitled to penalty interest on arrears in the amount of 8.12% per year.

Recommendation

Against the background of an uncertain legal situation and in the interests of continuing an untroubled tenant-landlord relationship, the contractual parties would be well advised to seek a mutually acceptable solution that takes the interests of both parties into account.

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

The effects of the coronavirus crisis on the annual financial statements and the management report

Besides the not yet predictable effects of the coronavirus crisis on the economy, the question that arises is what are its accounting implications. What are the consequences now already for drawing up the annual financial statements and the management report? The following guidelines apply to the consolidated financial statements and, by analogy, to the group management report.

1. The effects on the balance sheet and P&L as well as ...

The question that generally arises is whether or not the effects of the coronavirus crisis have to be reported in the annual or consolidated financial statements that have to be prepared, in accordance with German commercial law, for the financial year ending 31.12.2019. This will depend on whether the causes of the spread of the virus existed already prior to the reporting date or only after that date. If the cause was present prior to the reporting date then, in the sense of an adjusting event, all the financial consequences would have to be taken into consideration in the balance sheet as at 31.12.2019. If the cause was present in 2020 then this would constitute a non-adjusting event, as it did not occur until 2020, and no consequences whatsoever would have to be acted on in the 2019 balance sheet.

Shortly before the turn of the year, China informed the WHO about the first cases of coronavirus infections. At this point in time however, in Europe, it was not assumed that this constituted the start of a pandemic of the magnitude that we can see today. It was only the spread of the virus in 2020 that resulted in the current economic effects. Therefore, as the outbreak of the coronavirus crisis did not occur until 2020 it should be regarded as a non-adjusting event (also the view of the IDW [Institute of Public Auditors in Germany] in its Technical Guidance on the effects of the spread of the coronavirus on accounting, Part 1 from 4.3.2020). Due to the purely reporting date-based approach in the balance sheet, any effects that arise for the balance sheet (e.g. valuation adjustments for equity interests or receivables) will only have to be reported in financial statements with reporting dates after 31.12.2019.

... on the notes to the financial statements

The notes form part of the annual financial statements and fulfil a variety of functions. These include streamlining, interpreting, supplementing and adjusting the balance sheet and P&L. The adjustment function, in accordance with Section 285 no. 33 of the German Commercial Code (Handelsgesetzbuch, HGB), is performed through so-called supplementary reporting of: "events of particular significance that occurred after the end of the financial year and that have not been taken into account either in the profit and loss statement or the balance sheet, indicating their nature and financial effects."

Within the scope of supplementary reporting, the nature and financial effects of an event should generally be explained. In doing so, the coronavirus crisis and its significance for the business should be described. If it is not yet possible to quantify the financial effects then it would be sufficient to provide a qualitative description and to note that an assessment of the financial effects is not yet possible.

2. Cross-referencing notes/management report

In principle, in view of the similar nature of the report content, it is possible that a reporting requirement will arise for both the notes and the management report. To avoid duplication and to increase the transparency of forward-looking information it is possible to present the effects in a prominent place. The IDW, in its Technical Guidance (Part 3 from 8.4.2020) clarified that in the supplementary report it would be permissible to refer to the descriptions in the management report. This would be on condition that identical information would otherwise have had to be included in both reports and that in the supplementary report there is a clear reference to the management report.

The explanations in the supplementary and/or management reports have to adequately present the impacts on business. The time period for which the effects have to be presented should extend to the date on which the annual financial statements were drawn up; in the case of companies that are subject to mandatory audits this is normally the date of the auditor's report.

3. Specific effects on the management report

In the case of medium-sized companies and large companies, the management report complements the backward-looking information in the annual financial statements. According to Section 289(1) clause 4 HGB "the management report has to provide an evaluation and explanation of the developments that are expected as well as their main opportunities and risks". A distinction has to be made here between the reporting requirements in the risk report, on the one hand, and the report on expected developments, on the other hand.

3.1 Risk report

In the risk report, the following risk categories, in particular, are reportable:

- risks to the company as a going-concern, such as e.g., imminent illiquidity or impending over-indebtedness as well as
- risks that could materially affect the financial position, cash flows and results of operations of the business.

In the course of the coronavirus crisis, the liquidity risk or rather the risk of illiquidity, in particular, have to be documented. This can be done, e.g., in liquidity and financial plans extending at least to the end of the new financial year. The tax measures to bolster liquidity and the potential loans from the KfW (a German government-owned development bank) should be included in these plans.

3.2 Report on expected developments

In the report on expected developments, the management has to make statements about the anticipated (i.e. the planned) development of revenues and earnings for at least the first year after the balance sheet date. During the coronavirus crisis, the forecasting ability of those businesses affected will be adversely impacted to a great extent. Against this background, it would be sufficient to provide qualified comparative forecasts, such as e.g., " ... for the financial year 2020, in view of the coronavirus crisis, we expect significantly lower revenues … strongly negative EBIT…".

Vineyard in the Breisgau region

Conclusion

There is neither a requirement nor a possibility to take into account the coronavirus crisis in the balance sheet and P&L as at 31.12.2019. Nevertheless, you will have to give an account of the effects of the coronavirus crisis in the notes to the financial statements, in the so-called supplementary report as well as in the management report. The greater challenge is likely to be the preparation of the risk report where statements will have to be made as to whether or not, if all the risks are aggregated, the risk-bearing capacity can be ensured and the extent to which there are developments that could jeopardize the company as a going-concern. This could require, e.g., the presentation of annual liquidity and financial plans.


Hornberg in the Black Forest

WPin [German public auditor] Julia Rösger

Are eurobonds a suitable support measure for financially weak countries in the eurozone?

The issuance of so-called eurobonds is currently the subject of intense discussion (sometimes the term "coronabonds" is used). Up to now, eurobonds have not been issued and currently only exist as a proposed solution. Moreover, the design options continue to remain open on account of political, economic and also legal issues.

1. Government spending financed by government bonds

To finance their state budgets countries routinely issue government bonds. In this way they raise liquidity for the long term and compensate the buyers of these bonds with a fixed rate of interest. Here, the rate of interest depends, in particular, on the creditworthiness of the respective country. Countries with high levels of government debt have to pay higher rates of interest than countries with lower levels of government debt. Countries with high levels of government debt as well as a high default risk face the challenge that they will only be able to raise new capital on the market by offering a high rate of interest. Subsequently, the high amount of interest payable constitutes an additional burden for the budget. While Germany is currently able to raise capital virtually interest-free, countries like Italy have to guarantee considerably higher interest rates.

2. The concept of eurobonds

Eurobonds are supposed to address this challenge and offset the existing imbalance among the different EU member states. Instead of a government bond being issued by each individual country, the EU would act jointly to issue a bond. The creditworthiness assessment would then cover the highly indebted countries as well as those less heavily indebted. This would translate into an average interest rate that would take some pressure off the highly indebted countries. The debt would thus be mutualised because the creditors would rely on the good creditworthiness of the less indebted countries.

Please note: The term Eurobond is also used for Euromarket bonds where a company offers its bonds to investors in several countries. This type of Eurobond will not be considered here.

3. The European Stability Mechanism as an alternative

The European Stability Mechanism (ESM), which was established to manage the euro debt crisis in 2008/2009, replaced the European Financial Stability Facility (EFSF). The ESM hands out loans or guarantees to ensure that overindebted eurozone countries are able to make payments. In each case, these measures are tied to conditions related to economic policy reforms in the beneficiary countries and these are then monitored by the ESM. The ESM has subscribed capital of more than € 700 bn of which around € 410 bn is still available following the support measures that have been provided for countries like Greece, Portugal and Ireland since the establishment of the ESM. Germany provides approximately 27% of the funding volume of the ESM.

4. Weighing up the advantages ...

One particular positive argument is that, due to the participation of financially strong member states, eurobonds could possibly provide debt financing at levels of interest that could feasibly be paid. Eurobonds could basically be a way to help provide those eurozone countries that have poor creditworthiness with liquidity that they are able to fund and, thus, prevent individual member states from going bankrupt. The effects of the state bankruptcy of a large European economy and the consequences for other member states are not foreseeable and should therefore be avoided. A eurobond issue volume of one trillion euros could provide a major contribution of supplementary finance to the partially depleted funding volume of the ESM.

... and the disadvantages of eurobonds

(1) While the ESM ties its support measures to conditions related to economic policy reforms, in the case of eurobonds, financially weak countries would be under no obligation to take steps to improve their budgetary situation.

(2) For this reason, financially strong countries – including, among others, Germany – also view eurobonds critically because the way they work is based on the good creditworthiness of these countries and, moreover, the creditors rely on this strength in the system of joint liability should one or more member states default.

(3) From a legal perspective, this view is contradicted, in particular, by the "no bailout" clause laid down in the Lisbon Treaty (Art. 125 TFEU). According to that, the liability of the EU for the commitments of individual member states is excluded.

Conclusion

In view of the fact that the legal and organisational design has not yet even been basically negotiated or drafted, it is probably unlikely that eurobonds will be issued in the short term. Adopting a resolution with respect to the issuance of eurobonds will ultimately be a political decision and will be heavily dependent on the levels of government debt of individual countries and the speed of economic rehabilitation.

TAX

StB [German tax consultant] Ulrich Creydt

Changes in the area of transfer pricing rules – Part I: An overview of the important points

In conjunction with the draft law for the proposed transposition of the Anti-Tax Avoidance Directive (ATAD), the Federal Ministry of Finance (*Bundesministerium der Finanzen, BMF*) put forward important new rules in the area of transfer pricing. After the revisions, from 24.3.2020, that related solely to the ATAD transposition, the aim is to swiftly implement the draft law in accordance with the resolution passed by the Coalition Committee on 8.4.2020. The new regulations are expected to apply to financial years starting after 31.12.2020. In the following section we give an overview of the planned changes in the area of transfer pricing rules. A detailed presentation of the changes to the approach for precisely defining the arm's length principle will follow in part two, in the next issue of our newsletter.

1. Revision to Section 1 of the German Foreign Transactions Tax Act (Außensteuergesetz, AStG)

Section 1 of the Foreign Transactions Tax Act, which includes general guidelines for determining transfer pricing, will be revised and adapted to international standards. In particular, the aim is to implement the outcomes of the OECD BEPS project. In future, only the factual circumstances of a business relationship should be considered; the contractual relationships will, at most, provide a starting point for determining transfer pricing. Moreover, the definition of a "related party", as the criterion for the connection between taxpayers, will be expanded. Likewise, with a view to preventing tax structuring, cases of multiple voting rights, non-voting shares, pooled voting rights or comparable procedures would be considered to be relevant.

2. Transfer pricing documentation

Large groups of companies generally have to prepare not only company-related documentation (the so-called Local Files) but also master documentation for the group of companies (the so-called Master File) on the appropriateness of the transfer pricing. This was hitherto applicable to groups of companies who, in the previous year, had generated revenues of at least € 100m. This threshold will be reduced to € 50m.

An obligation to prepare the documentation without delay will be additionally introduced. In future, the master file will have to be submitted electronically directly to the locally competent tax office. The submission will have to take place annually by the end of the respective financial year. When applying these requirements to financial years starting after 31.12.2020, this would mean that, e.g., for the 2021 financial year, the Master File would have to be submitted to the tax office by no later than 31.12.2021. There has thus been a shift away from the previous practice according to which transfer pricing documentation usually only had to be produced if such information was requested in the course of a tax audit.

Please note: As a consequence of the significant reduction in the threshold value (revenues of € 50m in the previous year) you should check to see if, in 2021, a Master File has to be prepared and submitted annually to the tax office.

3. Advance agreement procedure for transfer pricing

The intention behind a new provision that will be added to the Fiscal Code *[Abgabenordnung, AO]* (Section 89a AO-E [-draft]) is to create an independent national standard for an advance agreement on the appropriateness of transfer pricing (Advance Pricing Agreement,"APA") for precisely defined business transactions. Under this provision, multilateral cases will be possible in addition to bilateral ones. Up to now, agreements were made on the basis of the respective double taxation treaties as well as the Federal Ministry of Finance fact sheet from 2006.

Requests for an APA have to be sent to the Federal Central Tax Office (Bundeszentralamt für Steuern, BZSt). The prerequisite for a request is that, at the point in time when it is made, the precise situation that has to be decided on is yet to be realised and the risk of double taxation can be avoided. Requests that discernibly relate to tax avoidance strategies would be rejected.

An agreement of understanding would normally not exceed a period of validity of five years and should be linked to the applicant's waiver of the right to lodge an appeal against the tax assessment insofar as this relates to what has been agreed.

The fee for an advance agreement application will be € 30,000; this amount will be halved in the event of an extension of an application that has already been decided on.

Outlook

In Part II will look into the approach for precisely defining the arm's length principle. Here, among other things, we will discuss method selection as well as the legal definition of "intangible assets"

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Important aspects of the German Research Allowance Act – Part I: Tax-privileged R&D projects

The Research Allowance Act *(Forschungszulagengesetz, FZulG)* came into force on 1.1.2020. The objective here is to provide support to companies for their research and development activities (R&D) in order to enhance the attractiveness of Germany as a business location and to spur innovation as well as investment. While here, in Part I, we discuss the definition of tax-privileged R&D projects, in Part II we will be going into the specific terms and conditions of eligibility.

1. Ways to promote R&D

As regards state support in the area of R&D, a distinction has to be made between direct funding (project grants) and indirect funding (tax incentives). The indirect funding in the form of the FZulG – in contrast to the funding policy to date – will not be linked to a specific project but the aim is rather to provide support irrespective of the corporate purpose, profitability and size of the enterprise. The

following section focuses on the R&D projects that are eligible for tax concessions under the FZulG.

2. Tax-privileged R&D projects

2.1 Eligibility criteria

With respect to defining tax-privileged R&D projects, the concepts of the legislators in Germany were guided by the definition of R&D in the "Frascati Manual 2015" from the OECD. Accordingly, the eligibility of R&D activities will basically be determined by the following five (cumulative) criteria. The activities have to be innovative, creative, systematic as well as transferable and/or reproducible while their final outcome essentially has to be fraught with uncertainty in terms of the resource outlay.

Specifically:

(1) Innovative – The R&D activity must result in findings that are new to the business and not already in use in the respective industry. Therefore, the excluded means of gaining knowledge will be activities undertaken to copy, imitate or reverse engineer.

(2) Creative – An R&D project must have as an objective new concepts or ideas that improve on existing knowledge. Routine changes to products and processes are thus not included in R&D, however, new methods developed to perform common tasks are. For example, data processing is not an R&D activity unless it is part of a project to develop new methods for data processing. Each new problem-solving strategy, developed as part of a project, could constitute R&D if the outcome is original and the other criteria are met.

(3) Systematic – The R&D process must run according to a fixed plan and the procedural steps as well as the results must be documented. The purpose and sources of funding should be identified.

(4) Transferable/ reproducible – An R&D project should result in the potential for the transfer of the new knowledge by ensuring its use and allowing others to reproduce the results as part of their own R&D activities. In a business environment, the results will be protected by trade secrecy provisions or other means of intellectual property protection and yet, at the same time, the individual procedural steps and the results should be documented so that they can be used by other researchers in the business.

(5) Uncertain – For R&D in general, there is uncertainty about the costs and time as well as about whether the objectives can be achieved at all. For example, uncertainty plays a major role when making a distinction between R&D prototyping (models used to test technical concepts and technologies where there is a high risk of failure in terms of applicability) and non-R&D prototyping (pilot production facilities used to obtain technical or legal certifications).

2.2 Types of research

The FZulG provides for three potential eligible areas of activity:

- basic research,
- applied research and
- experimental development.

Besides in-house research, funding is also available for research that has been commissioned (so-called contract research). In such a case, it is unimportant whether the contractor is based in Germany or the EU/EEA. Collaborations with research and knowledge agencies as well as with other enterprises are possible.

Mountainbiking in the Black Forest

Outlook

We will have to wait and see the extent to which, in practice, difficulties emerge in defining (non-)eligible R&D projects. The above-mentioned Frascati Manual does indeed provide – non-legally binding – guidance for taxpayers, however, there are still uncertainties. That is why, in Part II, we will initially highlight examples of projects that would be eligible for tax concessions and, in addition, go into the details of the eligibility conditions.

AND FINALLY...

"I don't create companies for the sake of creating companies, but to get things done."

Elon Musk, born 28.6.1971, Canadian-US American entrepreneur, founder, in particular, of PayPal, Tesla and SpaceX.

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