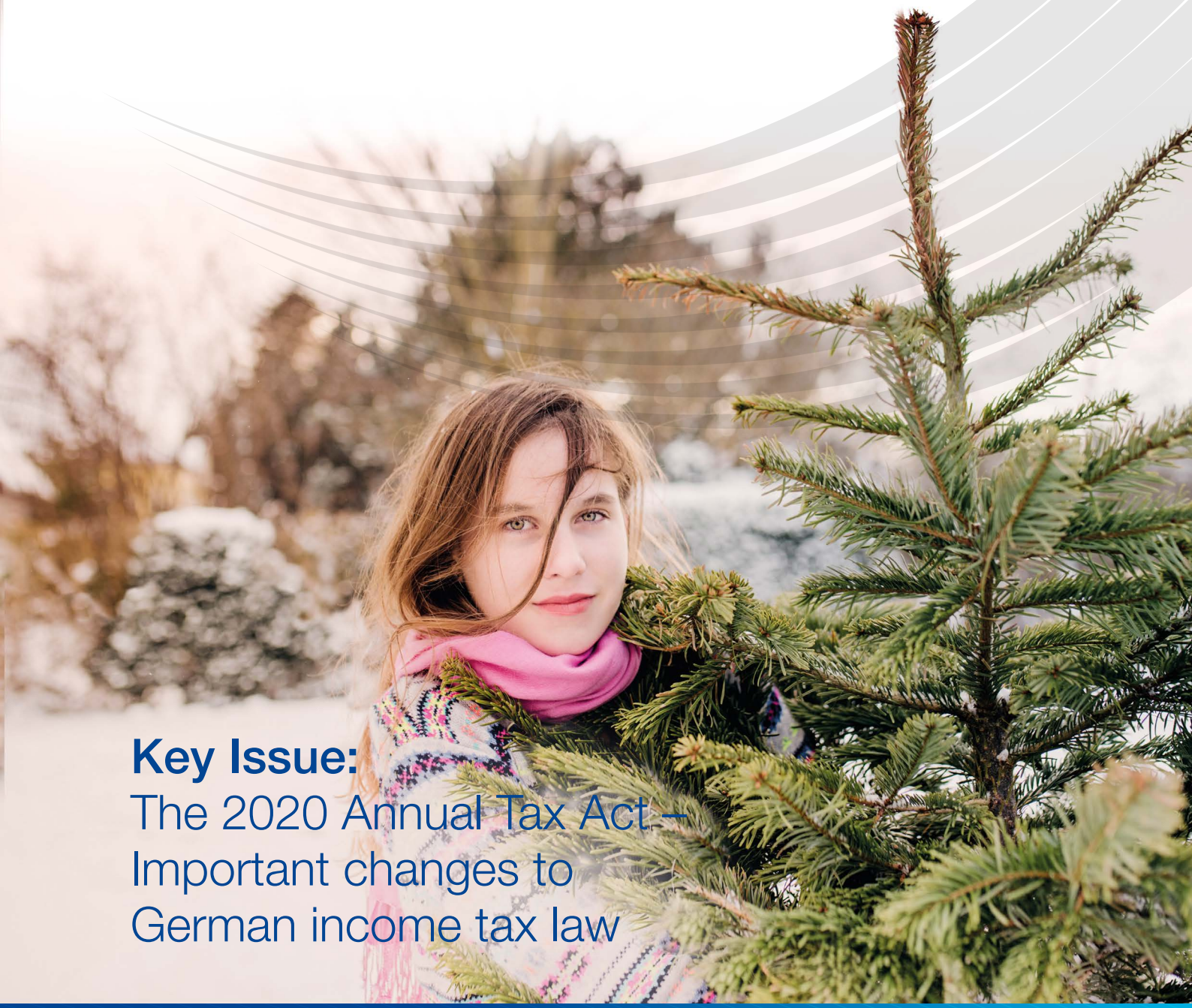
PKF

Newsletter



Key Issue:
The 2020 Annual Tax Act – Important changes to German income tax law

12|20

Dear Readers,

This time last year, we were even able to praise the German government for having presented the completed **Annual Tax Act** in November already. This year, by contrast, the Annual Tax Act will be pushed to one side although, in this case, it can remain an open question as to whether the reason lies in the tax issues or government capacities being otherwise tied up. Nevertheless, in the Key Issue section of this edition of our newsletter, we have a report on the **changes to German income tax law** that are almost certain to be adopted (those worthy of note are other legal changes to that were passed beforehand, for example, the declining balance method of depreciation in the 2nd German Coronavirus Tax-Related Assistance Act, cf. issue 7/2020 of the PKF newsletter). Information on the changes in the Annual Tax Act relating to other types of tax should then follow in the January edition of our newsletter.

The second contribution in the Tax section is about invoices in the **XRechnung** format – this refers to the format for electronic invoices issued to German federal agencies that has been mandatory since the end of November. Although, similarly to the coronavirus measures, the implementation of this format at the level of the federal states has likewise resulted in a patchwork of regulations. In the third contribution we report on the fiscal authority's latest view on the additional formal requirements for the tax exemption of intra-Community deliveries.

In the Legal section you will find explanations about a ruling by the highest German labour court in which it had to clarify if the applicable **notice periods for managing directors** were the same as the ones for employees.

In the Accounting & Finance section, we first take a look at situations where there could possibly be a need for change in **transfer pricing** due to the effects of the **coronavirus pandemic**. Subsequently, we examine a new reporting format, namely, the **European Single Electronic Format (ESEF)**, which will initially apply for capital market-oriented companies, but which could also have an effect that permeates through to SMEs.

And with that said, once again, another year is drawing to a close that, since March at the very latest, has been nearly solely affected by coronavirus-related issues. In the Spring and Summer editions of our newsletter we attempted to provide suggestions for holiday destinations in Germany by including impressions from around our lovely country. The cover picture for this issue just about sums up Christmas 2020 because the Christmas tree is about the only thing that we are still allowed to hug.

With this in mind, we would like to wish you not only an interesting read but also you and your families a lovely Christmas season combined with the hope that, in 2021, many things will be better.

Your Team at PKF

Key Issue

The 2020 Annual Tax Act – Important changes to German income tax law

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TAX

StBin [German tax consultant] Sabine Rössler

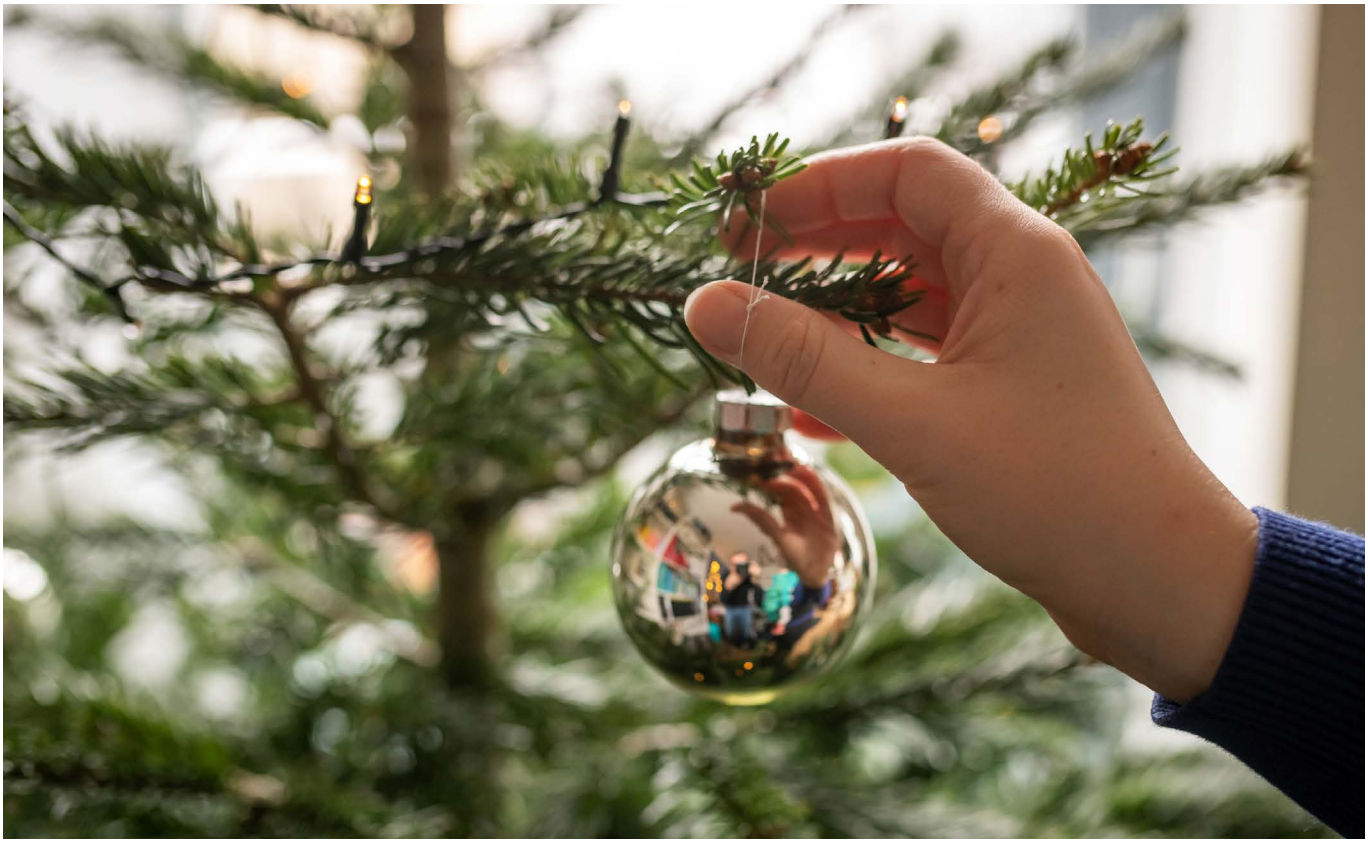
The 2020 Annual Tax Act – Important changes to German income tax law

In September, the lower house of the German parliament *[Bundestag, BT]* had already passed the Draft of the 2020 Annual Tax Act (BT printed matter 19/22850). Yet, even at the end of November, the Act was not able to pass through the upper house of the German parliament *[Bundesrat, BR]*. The subjects of contention are, in particular, the extension of the carry back rules for losses, inheritance tax issues as well as the revision of the laws that regulate non-profit organisations. In the sections below we present only the revisions to the income tax law that are almost certain to be adopted. We will then follow this up in the January issue of our newsletter with a discussion of the new rules relating to the other types of tax.

1. Investment allowances and special depreciation under Section 7g of the German Income Tax Act

Investment allowances *[Investitionsabzugsbeträge, IAB]* under Section 7g of the Income Tax Act *[Einkommensteuergesetz, EStG]* grant liquidity relief by bringing forward the depreciation potential to a financial year prior to the acquisition of assets that are eligible for tax deductions. The aim of the extensive revamp of Section 7g EStG is "more carefully targeted" planning and an enhancement of the recognition of IAB as well as a legislative and administrative simplification.

Specifically:
(1) In the future, **assets that have been rented out** would be eligible for tax deductions in the year when the investment was made and in the subsequent year. This would apply regardless of the respective rental period and even if the taxpayer rents out the asset to another own business. If the rents were not consistent with the arm's length principle then the offset would be carried out independently of Section 7g EStG via the existing regulations (e.g. deemed dividends).



(2) The share of investment costs that qualify for tax deductions under Section 7g EStG will be raised from 40% to 50%. The enhanced investment support would mean that the liquidity gain for eligible companies would be increased further and this would make the regulations more attractive.

(3) In future, for all types of income there will be a **standard profit limit** in the amount of € 150,000 as a condition for claiming IAB. The provision replaces the following criteria: € 235,000 (operating assets as recorded in the accounts), € 125,000 (economic asset in the case of land farmers and forest managers) and € 100,000 (profit from cash basis accounting systems).

(4) Up to now, it has been possible to apply for IAB even after a tax assessment has been issued, for example, in the course of an external tax audit. The aim is to prevent this, as the purpose of Section 7g EStG is to make future investments simpler and does not consist in providing tax deductions retrospectively for investments that have already been made and apparently adequately financed. In the future, **retroactive recognition** of IAB would be possible solely for investments in movable assets that had not yet been acquired at the time when the allowance was claimed.

Please note: Currently, these revisions would put a strain on businesses that are struggling with the economic consequences of the COVID-19 pandemic. Freeing up liquidity by means of retroactively claiming IAB would certainly be desirable, particularly in 2020 and 2021, when dealing with the economic consequences of the pandemic. The German Federal Chamber of Tax Consultants [Bundessteuerberaterkammer, BStBK] has therefore called for the postponement of the date of first application of the new regulations.

(5) An addendum to Section 7g(7) EStG clarifies that, by way of derogation from the case-law of the Federal Fiscal Court [Bundesfinanzhof, BFH], the **adding back** of IAB is only permitted within the asset sphere where deduction of the allowance was claimed. For example, if an IAB was claimed within the sphere of the special business assets held by a co-partner in a partnership then the investment allowance may likewise only be used for the investments made by that co-partner in his/her special business assets. This will ensure that the tax relief is granted solely to those who actually make the investments.

Please note: This planned new regulation is a response to the BFH ruling, from 15.11.2017 (German Federal Tax Gazette [Bundessteuerblatt, BStBl] 2019 II p. 466), according to which an investment that qualifies for a tax deduction within the meaning of Section 7g EStG would also be deemed to be such if the IAB had been deducted from profits generated by jointly owned assets but where, however, the subsequent investment was made in the special assets of one of the partners.

(6) Rented-out assets would be eligible not only for an IAB but likewise for **special depreciation** under Section 7g(5) EStG. The standard profit limit would also apply when claiming such special depreciation.

(7) The intention is for the increase in the IAB to 50%, the changes to the utilisation requirements as well as the standard profit limits to apply for the first time to IAB and special depreciation that are claimed for financial years ending after 31.12.2019. In the case of deviating financial years that ended before 17.7.2020 the old **company size criteria** could potentially be taken into account. This option can only be uniformly exercised for IAB and special deprecation.

(8) The restrictive regulations on the use of **retroactively claimed allowances** and in the area of partnerships would only be applied for IAB that are claimed in financial years ending after 31.12.2020.

2. Additionality requirement for benefits provided by employers

Section 8 EStG would include a legal definition of the conditions under which benefits provided by employers would be “in addition to remuneration due in any case”. The background to this is that a number of EStG rules related to tax concessions tie the respective tax relief to the precondition that a specific benefit provided by an employer is “in addition to remuneration due in any case”. The aim is to explicitly exclude tax concessions for situations that involve salary waiver or salary conversion.

The German government has thus responded to the current contradictory rulings by the BFH (from 1.8.2019, case references: VI R 32/18, VI R 21/17 and VI R 40/17). In future, only genuine additional benefits provided by employers may be tax-privileged. The benefits may not, among other things, count towards the entitlement to remuneration and this may not be reduced in favour of the benefit.

3. Expenses when renting out residential property below the commercial level

To avoid tax disadvantages for landlords who refrain from

periodically increasing rents by the permitted amounts in the interest of continuing long-term rental relationships the aim is to provide greater leeway so that it will still be possible to deduct allowable expenses from rental income despite moderate rental arrangements.

When making housing available at a reduced price of less than 66% of the average market rent for the local area, the provision for use of the housing has to be divided up into remunerated and non-remunerated portions; it is only possible to deduct the allowable expenses, on a pro rata basis, from the remunerated portion. The draft law provides for the limit at which dividing up into portions is required to be reduced to 50% of the average market rent for the local area. At an agreed rent of at least 66% of the average market rent for the local area there will be no change in the assumption – for which no detailed documentation will be required – that there is an intention to generate income.

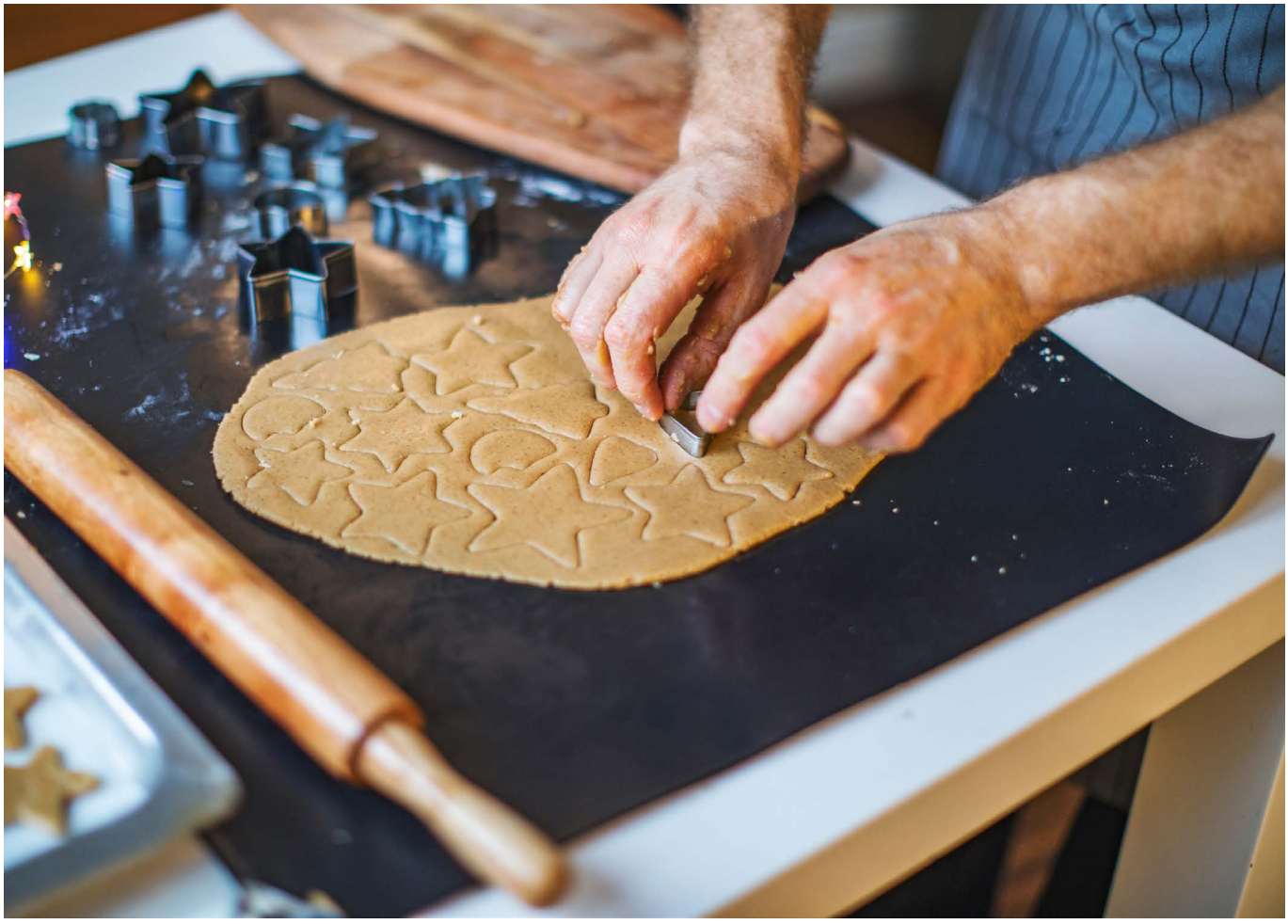
In the case of a remuneration of between 50% and 66% of the average market rent for the local area, in the future, a total surplus forecast check would have to be made. If the total surplus forecast turns out to be positive then it would be possible to deduct the full amount of allowable expenses for making the housing available at a reduced price. Otherwise, an intention to generate income should only be assumed for the remunerated portion with the consequence that allowable expenses may (only) be deducted on a pro rata basis.

4. Tax exemption for payments by employers to top-up the short-time working allowance

Section 3 no. 28a EStG, which was introduced via the Coronavirus Tax-Related Assistance Act of 19.6.2020 (BGBl 2020 I p.1385), in its latest version, provides for a limited and temporary tax exemption for payments by employers to top-up the short-time working allowance and the seasonal short-time allowance. The aim is to extend the time limit by one year. The tax exemption would thus apply to remuneration periods that begin after 29.2.2020 and end before 1.1.2022.

5. Automated exchange of data on premiums for private health insurance and for private mandatory long-term care insurance

Since 2009, payroll tax deductions for employees have been automatically regulated on the basis of payroll tax



deduction criteria. These criteria include, e.g., income tax class or any child allowance. The 2020 Annual Tax Act will provide for the introduction of a further payroll tax criterion, namely, the amount of the monthly premiums for private health insurance and private long-term care insurance; this would apply to cases where there are tax free subsidies that have to be granted by the employer and such cases where the premiums are deductible as special expenses.

The aim of the provision is to reduce administrative red tape. It has been designed as a pilot process for the future exchange of comprehensive data between private health and long-term care insurance companies. Within the framework of this pilot project the aim is to test the process with selected insurance companies and employers using real data in order to obtain reliable results for subsequent normal operation. The application of this process would be mandatory from 1.1.2024.

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

XRechnung format is mandatory when issuing invoices for public sector contracts

Since 27.11.2020, German federal agencies have only been paying invoices issued and submitted electronically in the XRechnung format. At the level of the federal states the obligations with respect to issuing invoices in the XRechnung format are non-uniform. In the following sections, we highlight important particularities that need to be taken into account with respect to the XRechnung format, its tax treatment and the contracts to which it applies.

1. Implementation

Issuing and submitting invoices electronically has been an option for German federal contractors since 27.11.2019 and for contractors of the federal states and municipalities since 18.4.2020. Ever since 27.11.2020, German federal contractors have been required to issue invoices solely in the XRechnung format and to submit them electronically. The legal basis for this is the E-Invoice Regulation (E-Rechnungs-Verordnung, ERechV) of 13.7.2017. Electronic invoices will thus ultimately become an essential feature of public sector contracts at the federal level – apart from the exceptions in sections 4 and 5.

2. Definition and transmission

According to Section 4a(2) of the E-Government Act (E-Government-Gesetz, EGovG) of 25.7.2013, an electronic invoice is one that has been issued, transmitted and received in a structured electronic format that allows for the electronic processing of the invoice. Under Section 4(3) clause 1 ERechV, the electronic invoice here has to be transmitted via a German federal administrative portal. Two options have been made available for this purpose:

» the ZRE (= Zentrale Rechnungseingangsplattform [Central Invoice Submission Platform]) for invoice recipients from the direct federal administration, or
» the OZG-RE (= Onlinezugangsgesetz-konforme Rechnungseingangsplattform [Invoice Submission Platform which complies with the Online Access Act]) for invoice recipients from the indirect federal administration and recipients of funding provided by the federal government

3. Components of an XRechnung invoice

For subsequent electronic processing an electronic invoice has to contain the mandatory elements in accordance with Section 5(1) and (2) ERechV in addition to the invoice components for VAT purposes pursuant to Section 14(4) of the German VAT Act (Umsatzsteuergesetz, UStG). Accordingly, the following information also needs to be provided:

» routing identification number,
» bank account information,
» payment terms,
» De-mail address or e-mail address of the issuer of the invoice,
» supplier code and purchase order number, insofar as these were already transmitted to the issuer of the invoice when the order was placed.

4. Differences at the level of the federal states

While the e-invoice requirement has been applicable for German federal agency contractors since 27.11.2020, at the level of the federal states the respective requirement is currently only applicable in Bremen. As the federal states are autonomously implementing e-invoicing there will be delays, which we have listed in the table on p. 8.

Federal State	E-invoice requirement for suppliers
Baden-Württemberg	**from 1.1.2022**
Bavaria	**No**
Berlin	**No**
Brandenburg	**No**
Bremen	**from 27.11.2020**
Hamburg	**No**
Hesse	**from 18.4.2024**
Mecklenburg-Vorpommern	**Still at the planning stage**
Lower Saxony	**No**
North Rhine-Westphalia	**No**
Rhineland-Palatinate	**from 1.1.2024**
Saarland	**from 1.1.2022**
Saxony	**No**
Saxony-Anhalt	**No**
Schleswig-Holstein	**No**
Thuringia	**No**

Tab. 1. Differences in the implementation of the e-invoice requirement

5. Deviation in the case of small amounts

Section3(3) ERechV lists the exceptional cases where the e-invoicing requirement does not apply. An XRechnung invoice would accordingly not have to be issued and the paper format would still be possible if

» the orders are direct and up to an order value of € 1,000 (net), or if
» confidential invoice information and certain foreign service matters or other foreign procurement are affected.

Therefore, apart from these exceptions, as of 27.11.2020, neither paper invoices nor invoices in electronic formats that solely contain a visual representation of the invoice (e.g. JPG photo files) have been permitted for orders placed by German federal agencies.

6. Tax requirements

For tax purposes, electronic invoices have been on an equal footing with paper invoices already since 2011. The requirement in clause 7 of Section 14(1) UStG, according to which the consent of the invoice recipient has to be obtained for electronic transmission, should not be applied if the clients are obliged to accept electronic invoices via the applicable EGovG. According to Section 147(1) no. 3 and 4 of the German Fiscal Code and Section 14b(1) clause 1 UStG, electronic invoices are documents subject to the record keeping requirement that have to be stored electronically in their original form and able to be provided in a readable format at all times during the mandatory record keeping period. The process to be implemented for the transmission of XRechnung invoices has to either be provided with controls or integrated into the internal control system (ICS) for taxes.

Please note: The selected procedure has to be described in documentation relating to tax procedures.

StB [German tax consultant] Marco Herrmann

Clarification by the Federal Ministry of Finance on the tightening of regulations for intra-Community deliveries

Additional legal requirements for the tax exemption of intra-Community deliveries have had to be complied with already since 1.1.2020. The Federal Ministry of Finance [Bundesministerium der Finanzen, BMF] recently expressed its view in this respect, for the first time, in a circular from 9.10.2020.

1. New legal situation

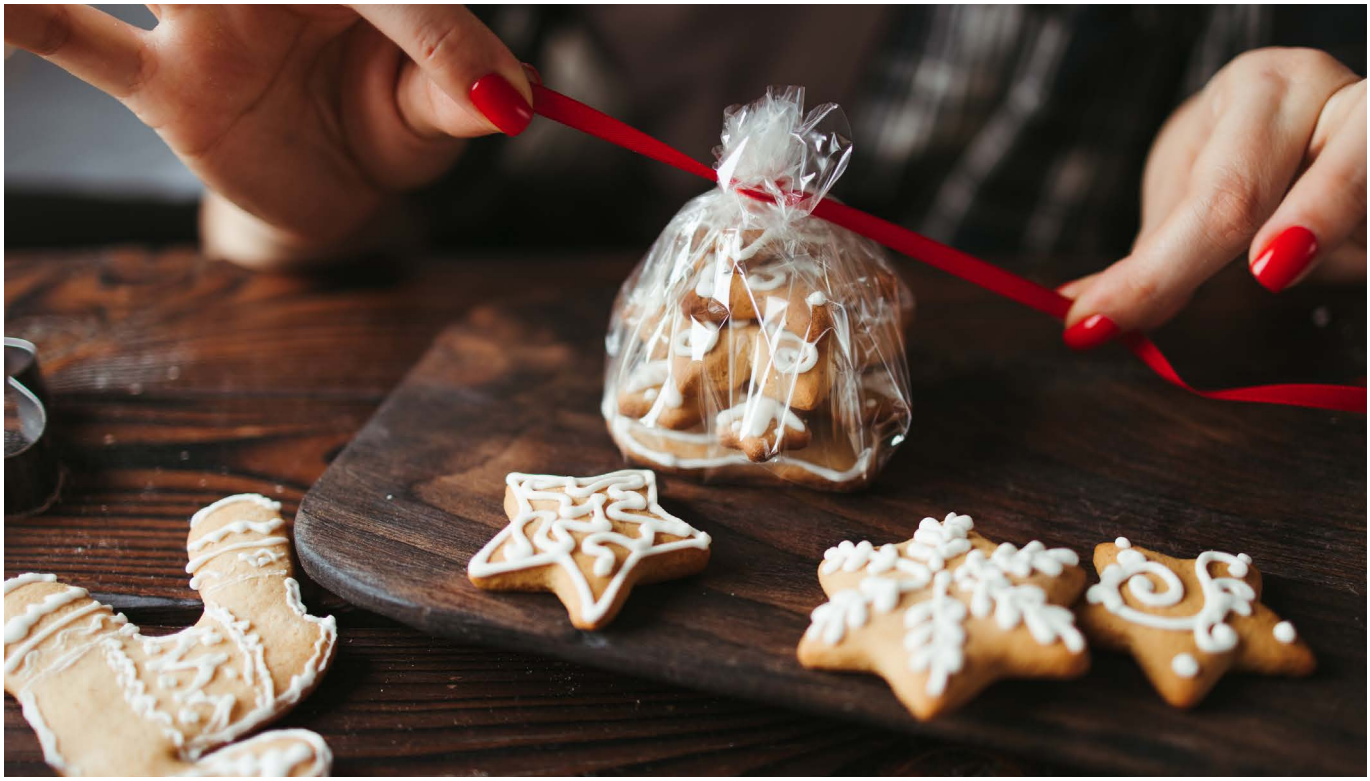
Since the start of 2020, the tax exemption of intra-Community deliveries (materially) requires, in addition, that

» the customer has to be registered for VAT in another Member State and has to use a valid VAT identification number (VATIN) vis-à-vis the supplier (Section 6a(1) no. 4 of the VAT Act [Umsatzsteuergesetz, UStG]) and that
» the supplier has to accurately declare the delivery in a recapitulative statement (RS) (Section 4 no. 1b UStG).

Otherwise the deliveries have to be treated as being VATable.

2. Application regulations

The BMF circular of 9.10.2020 (to adjust the German VAT application decree to these new statutory regulations) has now provided answers to issues that had thus far been unresolved. We would like to highlight three BMF provi-



sions that already have to be applied to all intra-Community deliveries carried out after 31.12.2019.

(1) The use of a foreign VAT identification number vis-à-vis the supplier may also take place retroactively. The retrospective use will have a retroactive effect for tax exemption purposes.

Please note: This simplification is to be welcomed. However, this should not obscure the fact that a tax exemption would nevertheless ultimately be precluded from the outset if, on the date of the delivery, a valid VATIN had not yet been issued to the customer by another Member State.

(2) The requirement for a tax exemption would be deemed not to have been satisfied if, in the RS, the delivery has not been declared correctly, fully or within the prescribed time limit.

Please note: Under Section 18a(10) UStG, an RS that was submitted within the prescribed time limit (time limit = no later than 25 days after the end of the reporting period) but was incorrect or incomplete by mistake may still be corrected within one month. The correction will have a retroactive effect with respect to the tax exemption. However, if an RS is not submitted within the prescribed time limit in the first place then, based on the BMF's statements, it has to be concluded that a tax exemption would already have been irrevocably precluded.

(3) The tax exemption for intra-Community transfers would likewise depend on these being correctly reported in the RS.

Please note: Unfortunately, the BMF circular does not contain any discussion of those cases where, through an error, intra-Community transfers were only subsequently determined to be such. If the business does not then have a foreign VATIN (which, in practice, is frequently the case) then the transfer would be VATable and, indeed, there would be no legal option that would enable the VAT that arises to be deducted as input tax (= definitive charge). It remains to be seen whether or not the fiscal authority will still provide for a practical solution in this respect.

Recommendation

The tightening of regulations and the BMF circular should prompt the businesses that are affected always to clarify the requirements for the tax-exempted treatment of intra-Community deliveries and intra-Community transfers in in good time before they are executed. Recapitulative statements should always be submitted within the prescribed time limit (and, indeed, even if the permanent extension to the filing deadline granted for the submission of preliminary VAT returns is possibly longer then the deadline for submitting the RS). Irrespective of this, it will still be very important for businesses to regularly check the VATIN used by their customers.

LEGAL

RAin [German lawyer] Katrin Heinicke / Elizaveta Berlin

New notice periods for external managing directors could potentially seriously disadvantage them

The Federal Labour Court [Bundesarbeitsgericht, BAG], in a recent ruling, amended the case-law on notice periods for external managing directors. This could be considerably disadvantageous for them. To substantiate this, the court argued that external managing directors do not exercise their function on the basis of an employment contract, but rather a service contract.

1. Starting Situation

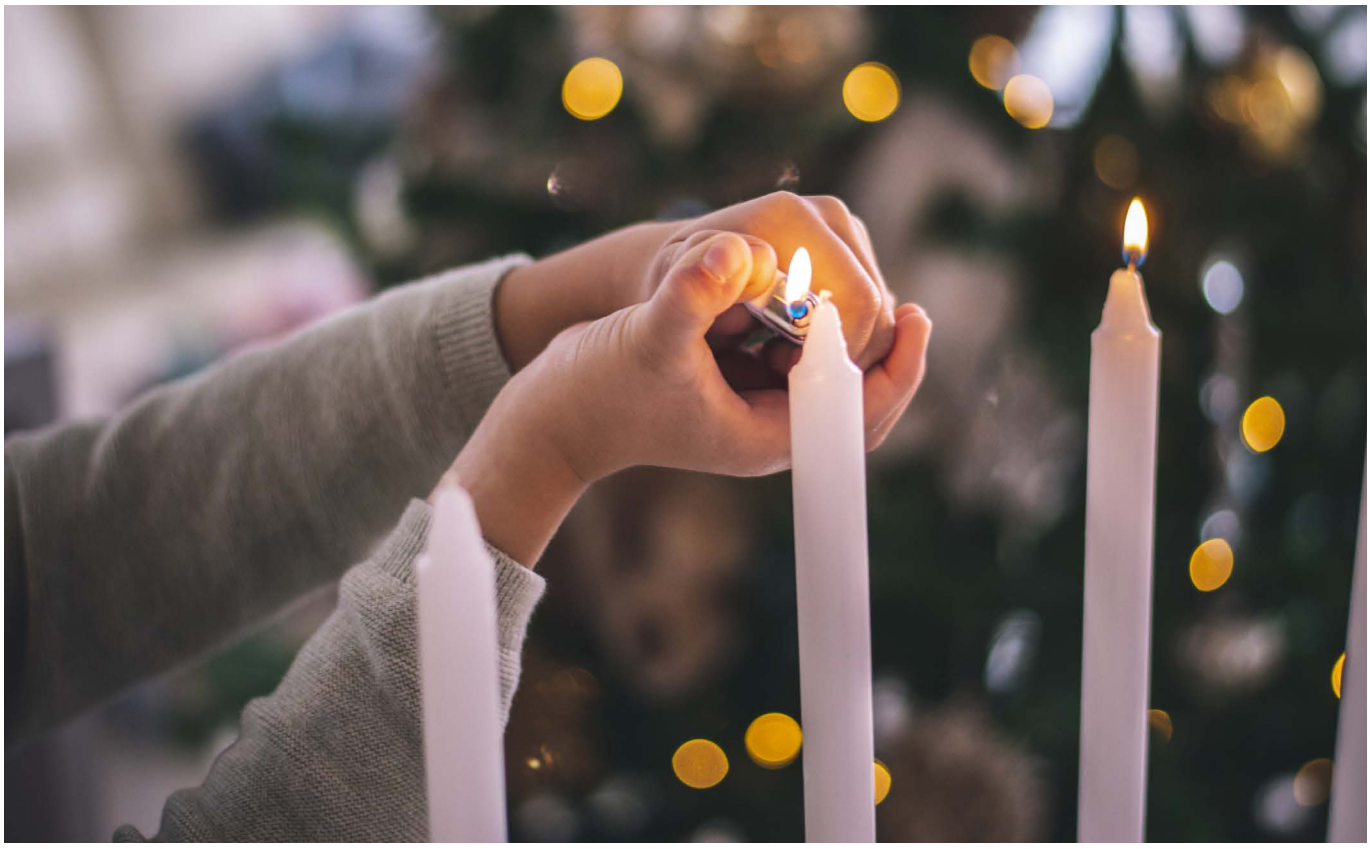
The term 'external managing director' is understood to mean a managing director who is not simultaneously also a shareholder/partner. The Federal Court of Justice [Bundesgerichtshof, BGH] had previously classified the function of an external managing director as an employee-like function. As a result, the staggered notice periods under Section 622 of the Civil Code [Bürgerliches Gesetzbuch, BGB] were applicable – these are based on the period of the employment relationship.

2. An about-turn due to the new BAG ruling

By contrast, however, in its ruling from 11.6.2020 (case reference: 2 AZR 374/19), the BAG decided that, in the absence of contractual arrangements in the service agreements of managing directors, statutory notice periods that apply to employees may not be invoked. Therefore, this constitutes a deviation from the previous case-law of the BGH that had declared that the notice periods for employees were applicable.

Please note: Despite this deviation from BGH case-law, the BAG did not refer the issue to the Joint Senate of the Highest Federal Courts of Justice since the BAG did not view the legal gap as being contrary to plan.

In its statement of justification, the BAG held the view that external managing directors exercise employer-like functions since, as officers of the company, they have powers of representation that cannot be restricted externally and



that, generally, distinguish external managing directors from employees – even executive staff. External managing directors do not exercise their function on the basis of an employment contract, but rather on the basis of a service contract. It follows that the applicable notice periods are those under Section 621 BGB, according to which these are based on the periods by which the remuneration is assessed. In the case of remuneration for the managing director that is generally on the basis of monthly assessments, notice of termination would therefore already be permitted by the 15th of one month to the end of the calendar month. In the case of remuneration on a daily or weekly basis, this would normally result in a notice period of one day or one week respectively.

3. Result

Herein lies a serious potential disadvantage for external managing directors, especially in cases where the employment relationship has already lasted for many years.

Recommendations

Against this background, it is recommended that the employment contracts for managing directors concluded up to now should be reviewed with respect to their rules on notice periods. If they include a reference to the statutory provisions then this would mean that the notice periods under Section 621 BGB would apply. It would only be possible to apply the notice periods under Section 622 BGB by making the respective contractual adjustment. To avoid legal uncertainties, an express provision on notice periods should be inserted when new employment contracts for managing directors are being concluded.

ACCOUNTING & FINANCE

RAin/StBin [German lawyer/tax consultant] Beate Jost

Coronavirus effects for transfer prices – Reviewing and adjustment requirements

Multinational groups of companies have to grapple not just with the challenges of national tax law, but also the effects on their transfer pricing systems arising from COVID-19; in particular, the decisions that are made will have to be promptly documented and contracts adjusted accordingly. It can be assumed that in the course of future tax audits the impact of COVID-19 on international income allocation will come under more intense scrutiny. In the sections below we discuss the areas where a "coronavirus-induced" need to review and make adjustments could arise.

1. Adjustments to target profit margins for entities that perform routine functions

Generally speaking, crisis-induced losses have to be allocated to the "entrepreneurial entity". Entities that perform routine functions (e.g. sales companies) normally have lower and relatively stable profits allocated to them. A loss is basically incompatible with the status of being an entity that performs routine functions. A transfer price for an entity that performs routine functions can be determined according to the transactional net margin method (TNMM) and on the basis of database analyses as well as according to the cost plus method or the resale price method. The TNMM uses database analyses that are backward looking and they would not yet reflect the current global slump due to COVID-19. However, it is obvious – and verifiable on the basis of past experience in the context of the financial crisis 2008/2009 – that target profit margins will decline after some delay; therefore, it will be necessary to adjust the comparative data for the previous years.

The fact that corporate groups in particular sectors are generating considerable and extraordinary overall losses due to the COVID-19 crisis will lead to the consequence – irrespective of the selected transfer pricing method – that, besides the entrepreneurial entity, entities that perform routine functions will likewise suffer a decline in profitability and will, potentially, even have to bear a share of the losses; even more so as, in such an extraordinary situation, unrelated third parties would likewise agree to make adjustments.

Please note: It is important to make adjustments to the respective agreements as well as to have available accu-

rate and transparent documentation with adequate justification to provide to the fiscal authorities in the future.

2. Adjustments to regular royalty payments and intragroup service charges

Generally, royalties should also be regularly examined with a view to adjustments that might be needed. Royalty payments are admittedly mostly linked to sales so that a decrease in sales would also be accompanied by lower royalty payments. However, it may be necessary to look beyond that and to adjust the royalties themselves or, in consideration of the economic conditions, to suspend them altogether. If licensees are in ongoing loss-making situations then a temporary adjustment or suspension of royalties could be appropriate since the fiscal authority would consider a licensee's loss-making situation to be a general indicator for an unreasonable price.

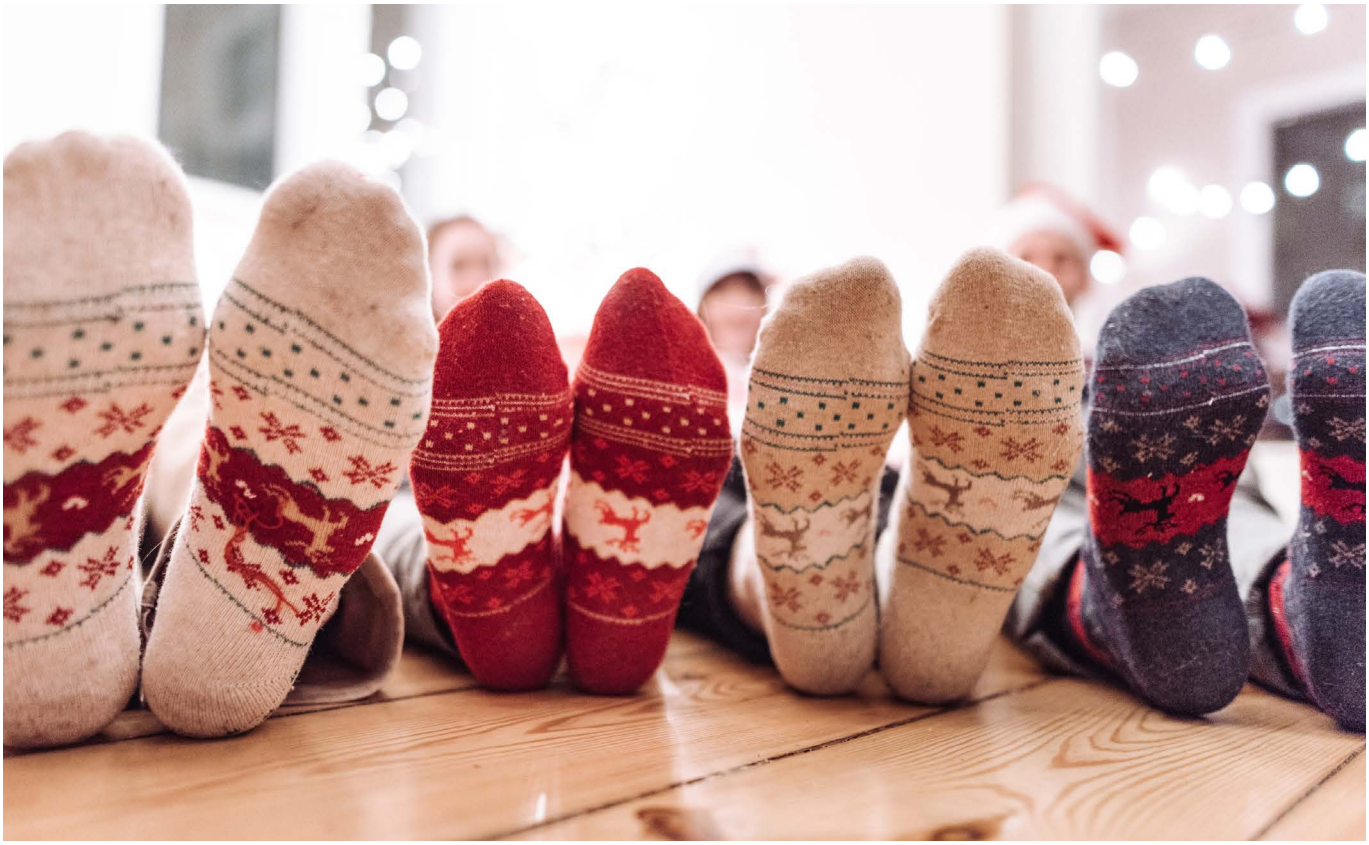
However, the situation would be different in the case of intragroup service charges where the amount is generally determined on the basis of the cost plus method. Waiving or reducing the charges in the case where the recipient of those services is in a loss-making situation cannot be considered whilst taking into account the arm's length principle. The only option would be to defer the service charge – this would then have to be offset subsequently, within an appropriate period of time, once the group company had attained profitability.

3. Safeguarding liquidity and financing

The forced business closures, nose-diving sales markets and uncollectable receivables resulting from COVID-19 coupled with unchanged cost structures etc. could lead to liquidity shortages at individual group companies or across the group. Therefore, to preserve liquidity it is essential to have short-term and medium-term internal as well as external liquidity planning that takes into account appropriate transfer prices.

Cash pooling – especially if this has already been implemented – is a suitable way to safeguard liquidity in the short term and to ensure that the group and the participating group companies have sufficient liquidity. The cash pool leader is responsible for ensuring that the group has sufficient funds available, potentially also via external financing. If the external liquidity costs of the cash pool leader have gone up then the cash pooling conditions should be examined with a view to their appropriateness. In particular, there should be a review as to whether the cash pool leader's risk was appropriately remunerated and whether individual companies that are particularly at risk should, potentially, be removed from the cash pool and have to have separate financing via longer-term loans.

If the COVID-19 crisis additionally results in group companies not being able to pay their outstanding debts that become due as per the agreement, it is recommended to



adjust the payment terms for intragroup trade receivables, where necessary by adding interest in accordance with arm's length principles, and to prolong intragroup loans.

Please note: In this connection, the interest rate should likewise be adjusted to the new term of the loan and the amount of interest should be reviewed to determine whether or not it is appropriate in view of the crisis situation and stands up to an arm's length comparison.

However, with "coronavirus-induced" support measures it could even be possible – based on the ECJ ruling in the "Hornbach-Baumarkt" case – that, in an ongoing loss-making situation, an interest-free or unsecured loan could be granted between a parent company and its subsidiary, or the parent company could provide the financing bank with a comfort letter without receiving liability remuneration for this. If it were possible to provide documentary evidence of a relevant commercial justification that requires an agreement that deviates from the arm's length principle in order to ensure the economic viability that would otherwise be threatened then the fiscal authority would not be permitted to attribute profits.

Recommendations

Besides the areas discussed above, there could still be other areas that will require adjustments because of the coronavirus crisis, such as, e.g., a reappraisal of transfers of functions or IP evaluations. Companies should therefore check existing structures and, if necessary, reorganise themselves. Any readjustment of the transfer prices would have to be documented accordingly and the relevant contracts updated.

WPin [German public auditor] Julia Hörl / Sebastian Vor

Disclosure requirements – Implementing the European Single Electronic Format (ESEF)

From 1.1.2021, companies that have issued securities on an organised market will have to publish their annual financial statements in accordance with the uniform EU-wide ESEF requirements. In corporate groups the related formatting requirements could radiate to the subsidiary levels. The audit obligations of auditors of annual accounts have likewise been expanded accordingly.

1. European Single Electronic Format (ESEF)

In Regulation (EU) 2018/815 the EU Commission created a set of rules with the aim of ensuring uniform EU-wide electronic reporting. Companies that have issued securities on an organised market insofar as they are not corporations within the meaning of Section 327a of the Commercial Code *[Handelsgesetzbuch, HGB]* fall within the scope of application of the Regulation.

In Germany, the Regulation was adopted via the ESEF Implementation Act ("Act on the Further Implementation of the Transparency Directive and its Amending Directive with Regard to a Common Electronic Format for Annual Financial Reports"), which was published in the Federal Law Gazette on 18.8.2020. The formatting requirements will have to be implemented for the first time for financial years beginning after 1.1.2020.

2. Financial statements in accordance with HGB

The ESEF Implementation Act amended Section 328 HGB. In future, the disclosure documents (annual financial statements, management report, consolidated financial statements, group management report and the statements by the legal representatives) will have to be submitted to the German Federal Gazette *[Bundesanzeiger]* in EXtensible HyperText Markup Language (XHTML) format. This requirement will also apply in equal measure to single-entity financial statements and consolidated financial statements.

3. Financial statements in accordance with IFRS

For financial statements that have to be prepared in accordance with IFRS there is an additional requirement to mark up items using Inline XBRL (iXBRL) that has to be taken into account. The aim of this marking up (so-called 'tagging') is to make financial information machine-readable and, thus, more easily accessible. The mandatory markups using tags are:

» 10 core data elements shown in Table 1 in Annex II of Regulation (EU) 2018/815 as well as
» information from the main components of the financial statements (balance sheet, statement of comprehensive income, cash flow statement and statement of changes in equity).

Mandatory tagging will be expanded for financial years beginning after 31.12.2021 to include the information stated in Table 2 in Annex II of Regulation (EU) 2018/815. In this connection, the block in the notes that contains the relevant information will also have to be marked up (so-called "block tagging").

Please note: Annex IV of Regulation (EU) 2018/815 contains a list of the labels that have to be used. It is not exhaustive and is certain to be further supplemented.

4. Audit of the requirements by auditors of annual accounts

In future, Section 317 HGB will be supplemented with a paragraph 3b according to which auditors of annual accounts will be required to form an opinion as to whether or not the disclosure documents from the previous year satisfy the requirements under Section 328(1) HGB. Furthermore, auditors of annual accounts have to review the disclosure documents in order to determine whether or not the machine-readable presentation of the disclosure documents is identical to the prepared accounting documents and whether or not the data meet the technical specifications and are properly marked up. This includes auditing the internal controls of the technical validity of the technical specifications set out in Regulation (EU) 2018/815. For these three main areas, auditors of annual accounts have to provide both an auditor's report as well as an auditor's certificate in a separate section.

Conclusion

After having harmonised the contents of annual reports, the EU Commission is now also standardising their format by providing requirements for corporate disclosure that have to be met. Financial information in XHTML format with iXBRL data tagging can be read and evaluated electronically. The scope of audits for auditors of annual accounts will include, besides a focus on the internal controls of the technical validity, checks of XHTML reports to ensure that the content matches that of the accounting documents and verifying that iXBRL markups meet the requirements. In this respect a separate section will have to be added to the auditor's certificate.

The GmbH – Bonus inflow in the case of a delay in the approval of the annual financial statements

According to a court ruling, in the case of controlling shareholding managing directors it should be assumed that an inflow of income could be deemed to exist earlier even without payment or a credit transaction. Whether or not the inflow should be notionally brought forward in the event of a delay in the approval of the financial statements was the subject of a recently published ruling by the Federal Fiscal Court *(BFH)*.

The Munich judges based their justification on the argument that it is usually in the hands of controlling shareholders to have amounts paid out that are due to them if the claim is straightforward, undisputed and payable. However, this notional inflow only applies to salary payments, or other remuneration

» that the GmbH owes to the controlling shareholders and
» that have impacted the calculation of the income of the GmbH.

Bonus claims only become due once the annual financial statements have been approved, unless the contractual parties agree a different payment date in an employment contract that is effective under civil law and complies with the arm's length principle. However, in the case of a delay in the approval of the annual financial statements the bonus inflow will not be automatically brought forward to the date when it would have been due if the annual financial statements had been drawn up on time. This was the view of the BFH in its ruling from 28.4.2020 (case reference: VI R 44/17) also with respect to controlling shareholding managing directors.

In the case in question, according to the employment contracts of the shareholding managing directors, the bonuses were due and payable one month after the approval of the annual financial statements by the shareholders' meeting. For higher bonuses, as in the above-mentioned case, a business naturally needs more time to produce the liquidity for the payment and that is why the BFH accepted one month's delay.

Please note: The BFH ruled that the delay in the approval of the annual financial statements was unimportant in this case, since the lower tax court had not established that the legal requirement for timely approval of the annual financial statements had not been complied with "arbitrarily".

Contributions – Blocking period violation in the case of a merger at book value

There are a number of German Reorganisation Tax Act provisions that have to be taken into account in the case of reorganisations. In particular, blocking periods have to be observed in order to prevent or mitigate the supposed abuse of tax structuring options.

One of the most relevant blocking periods, in practice, applies to contributions to a corporation. If a (divisional) business operation or co-owner's shareholding is contributed at book value or an intermediate value in return for new shares in a corporation then the shares received in return would be subject to a seven year blocking period at the shareholder level. In the event of a sale of the shares by the shareholder within this period, the hidden reserves would have to be realised retroactively back to the date of the contribution and, in fact, reduced by one seventh of the hidden reserves per year.

The relevant provision for a blocking period violation is very broadly defined and includes many substitute realisation situations. For example, if a profit distribution that is too high has been made out of the contribution account for tax purposes then this would trigger a blocking period violation. Recently, the Münster tax court had to decide what constitutes a harmful (from a tax viewpoint) event in its ruling from 19.5.2020 (case reference 13 K 571/16 G, F). In the case in question, a subsidiary German limited partnership [KG] contributed a business operation into a newly founded lower-tier subsidiary German limited company [GmbH] in return for new shares at book value. A year later, the subsidiary KG was merged into its parent GmbH, namely, at book value. There was no capital increase at the parent GmbH. Nonetheless, the judges recognised that there had been an exchange here that they classified as an event that had violated the blocking period.

AND FINALLY...

"Running a single business properly with good service and being present is better than having ten businesses with poor service."

Udo Walz, 28.7.1944 – 20.11.2020, was a German hairdresser. He became well known through his prominent clientele and various media appearances.

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