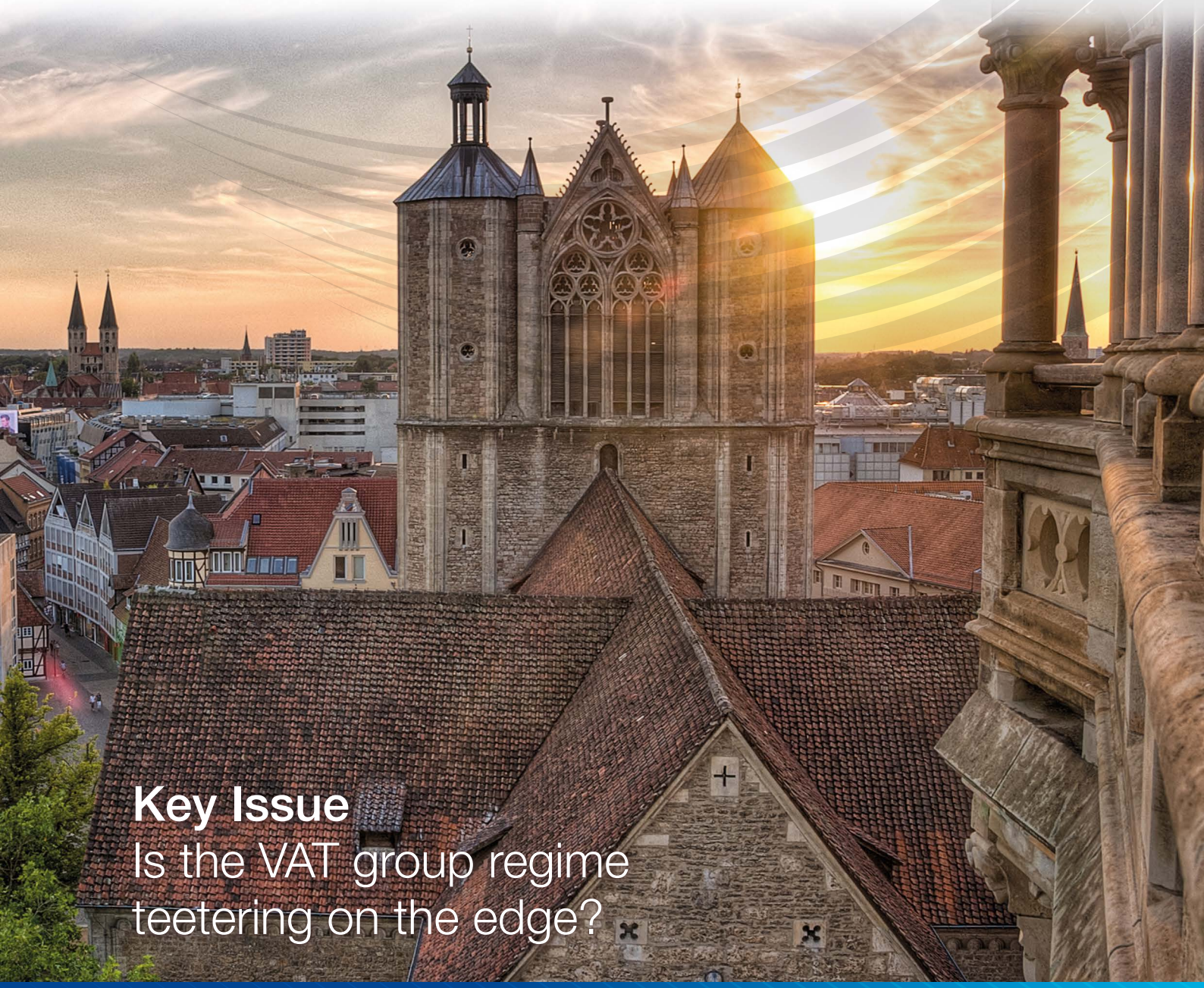
PKF

Newsletter



Key Issue
Is the VAT group regime teetering on the edge?

03|22

Dear Readers,

In recent times, we have been able to report encouraging news about the VAT group regime, namely, that partnerships can now also be subsidiaries in such groups. In the Key Issue section of this March edition of the PKF newsletter you can read about why the entire **VAT group regime is now on the verge of extinction**. This would result in huge revenue losses for the German fiscal authorities yet, by the same token, companies with a tax group for VAT purposes would be able to benefit from this.

Next up, in the Tax section, we have a report on a recent Federal Fiscal Court ruling according to which, in the future, a **corporation's profit appropriation would no longer have to take place on a uniform basis**, instead, a dividend could be paid to particular shareholders and the retention of profits could be determined for others. Subsequently, we provide a review of the conditions under which the withdrawal or the use of self-generated electricity can be free of tax. We then focus on **tax changes**. In **Germany**, a number of changes have already been introduced to provide relief for low-paid workers and employees in order to reduce the burden of rising energy costs and inflation. Further tax changes are planned in order to alleviate the consequences of the coronavirus pandemic, in particular, the extension of the carry back rules for losses in respect of the amount and the time period. This is then followed by a guest contribution from our PKF colleagues in **France** about the **reduction in the corporation tax rate** there.

In the Accounting and Finance section, we examine the **IBOR reform**. As a result of the abolition of LIBOR, products based on this benchmark will then potentially no longer have a valid reference rate; this will give rise to **questions relating to recognition and measurement under German GAAP and IFRS.**

When partners exit from family enterprises, normally, you need to take account of the **continuation clauses** in the **partnership agreement** – in the Legal section we analyse the effects of these. In cases where the exit is a result of death, such clauses can lead to considerable **inheritance tax charges** even if the successors are family members.

Once again, we continue our journey around the PKF locations in Germany through the illustrations that break up the reports from our experts – this time we visit Braunschweig.

We hope that you will find the information in this edition to be interesting.

Your Team at PKF

Front cover photo: Braunschweig Cathedral St. Blasii

Key Issue

Is the VAT group regime teetering on the edge?

Contents

TAX

StB [German tax consultant] Thorsten Haake

Is the VAT group regime teetering on the edge?

In two ongoing preliminary ruling proceedings before the ECJ, which were initiated by the Federal Fiscal Court *(Bundesfinanzhof, BFH)*, the opinions of the Advocate General were recently published. In both sets of proceedings the issue is essentially about whether or not the provisions in Section 2 of the VAT Act *(Umsatzsteuergesetz, UStG)* on the VAT group regime are compatible with EU law. If not, then there is a risk that Germany would lose significant tax revenues.

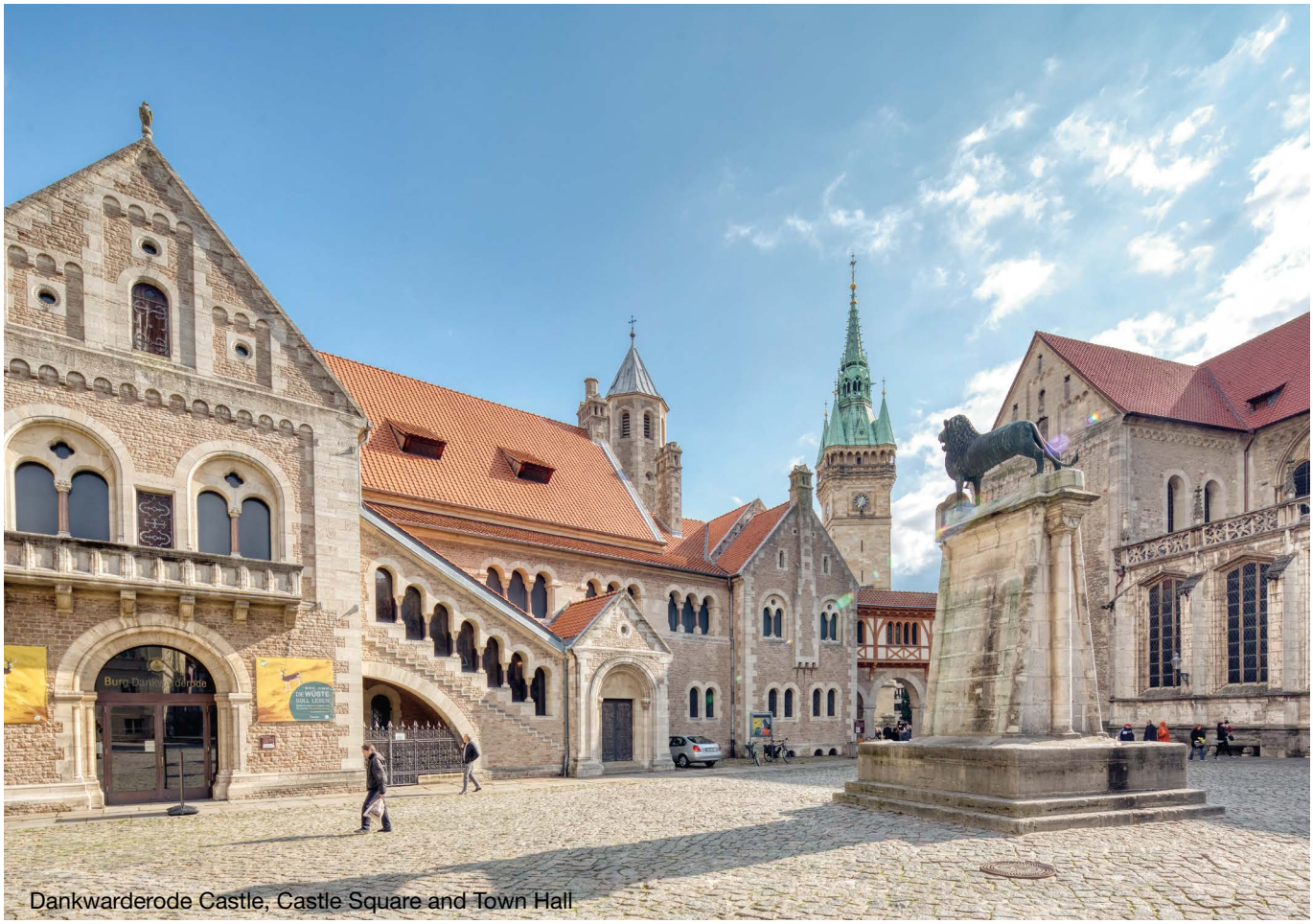
1. VAT groups under German national law

Section 2(2) no. 2 UStG includes a legal definition of a tax group for VAT purposes. According to that, a commercial or professional activity is not deemed to be performed independently if, within the actual overall circumstances, a legal entity is integrated financially, economically and organisationally into the business of the tax group's parent company. In view of the underlying EU law, partnerships can now also be recognised as subsidiary companies if certain conditions are met.

The legal consequences of the VAT group regime consist in, in particular, the subsidiary c ompanies being treated as legally dependent parts of the undertaking and the tax group's parent company being liable for the VAT for the entire group of companies consolidated for tax purposes.

2. Preliminary ruling proceedings initiated by the BFH

Both sets of preliminary ruling proceedings (case C-141/20 and C-269/20) address the legal issue of whether, under EU law, the underlying authorisation to establish a consolidated tax group requires the entirety of the subsidiary companies (also referred to as the 'VAT group') to be treated as being liable to pay tax, or whether



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it is also permissible – as in Section 2 UStG – to treat one of the subsidiary companies as being liable to pay tax.

In one of the two sets of the initial proceedings (case reference: V R 40/19), the BFH explicitly dealt with, among other things, the potential fiscal implications of the German provisions constituting an infringement of EU law. In such a case – which would be the most disadvantageous for the German fiscal authorities – the tax group's parent company could then specifically defend itself against tax assessments that have been previously been issued and are binding upon it, while a tax assessment that is binding upon a fictitious taxpayer (the 'VAT group') as well as upon the group's subsidiary companies would not be possible owing to the absence of an existing legal basis.

3. Opinions of the Advocate General

The Advocate General made it perfectly clear in her opinions, which were published on 13.1.2022 and 27.1.2022, that she deems the provisions on VAT groups under Section 2 UStG to be contrary to EU law. She countered the suggestion from the BFH that there could be significant tax revenues losses – which was understood to be a 'warning' – by stating that Germany has had sufficient time "in order to remedy the problems identified regarding its VAT group regime".

The Advocate General furthermore argued that the members of a 'VAT group' should remain independent taxpayers and have to submit their own tax returns. This implies that intra-group sales would also possibly have to be treated as taxable supplies.

4. The potential ramifications

It is not possible to predict what the ECJ will decide in these proceedings. It does indeed frequently follows the arguments put forward by the Advocates General, yet this is however not necessarily always the case.

From the present point of view, it is likewise completely uncertain what consequences would arise should the ECJ rule that the current VAT group regime is incompatible with EU law, something which is quite within the realms of what is possible. If the fiscal authorities were to face the threat of tax revenue losses then they would undoubtedly pull out all the stops in order to minimise these losses.

Recommendation

In order to secure the potential advantages that would arise from a judgement by the ECJ, all tax group parent companies should check if it makes sense for tax periods that are currently still open to continue remaining procedurally open until there is clarity about the ECJ judgement and its consequences.

StBin [German tax consultant] Elena Müller

Income from capital assets – Split and incongruent appropriations of profits

The consequence of a recent Federal Fiscal Court *(Bundesfinanzhof, BFH)* ruling is that a temporally disproportionate and subsequently incongruent dividend distribution (appropriation of profits) by a corporation to its shareholders has to be recognised for tax purposes. Previously, it was solely profit distributions that deviated from the shareholding percentages where there could be no objection.

1. The appropriation of profits resolution and the profit distribution resolution

A profit distribution resolution will determine whether shareholders are entitled to the profit to be distributed on the basis of their shareholdings or in deviation from their shareholding percentages. An appropriation of profits resolution provides the basis for shareholders to decide on a dividend distribution, the allocation to revenue reserves, or retained earnings to be carried forward to the following year.

2. Effectiveness under civil law is always required

Effectiveness under civil law is always crucial for the recognition of agreements for tax purposes. This specifically requires relevant provisions, in the corporation's articles of association, on the distribution of profits and the appropriation of profits as well as a shareholders' resolution that is permissible under corporate law.

If these requirements have been fulfilled then, for tax purposes, there should be no objection to a split/ incongruent appropriation of profits.

3. Income from capital assets and its transfer

The BFH, in its ruling of 28.9.2021 (case reference: VIII R 25/19), had had to decide on the date of the cash inflow of profit shares arising from shareholdings in a GmbH [a German limited liability company] and, thus, on the date when this income would need to be taxed as income from capital assets. In the specific case, the profit shares were distributed to the minority shareholders and, by contrast, the share of the profits that was attributable to the majority shareholder – which was based on the size of their shareholding – was allocated to a shareholder-related revenue reserve. A shareholders' resolution had been passed that was effective under civil law.

The profit shares (dividends) and other payments arising from participations in the GmbH constitute income from capital assets for the shareholders. Access by the shareholder to their profit share is crucial for determining the date for the imposition of tax, i.e. a specific due claim to the profits.

According to the BFH, in the event that the profit is allocated to a personal revenue reserve then the date of the cash inflow would not yet be clear. This reserve was recorded as a revenue reserve under the company's equity. It did not result in an inflow of capital gains for the controlling majority shareholder, according to the BFH. This is because this reserve is not freely available to the shareholder. In fact, a separate resolution would have to be passed for a dividend distribution to be made out this reserve.

Moreover, the BFH clarified that such an appropriation of profits resolution does not constitute abusive structuring. This is because it is based on economic reasons that should be recognised and is neither atypical nor inappropriate.

4. Conclusion

This BFH ruling will be of interest, in particular, for corporations where the shareholder structure is heterogeneous. In accordance with the different interests of the shareholders, it will thus be possible to tax the profit shares either on the date of the dividend distribution or else postpone taxation to a later date by crediting the profit shares to personal reserve accounts.

This may however also entail risks. Given that the accumulated profits have to be recorded as part of equity, in the event of a loss a dividend distribution would not be possible.

Please note

Furthermore, this most recent BFH ruling is of far reaching significance for partnership organisations and professional partnerships (Personenhandelsgesellschaften, a German type of professional corporation) that opt for corporation tax in accordance with Section 1a of the German Corporation Tax Act. Shareholder accounts that existed prior to the opting to be taxed as a corporation will, when the option is exercised for the first time, be consolidated into one single contribution account for tax purposes for the corporation without establishing an allocation between the individual shareholders. From now on, it will be possible to set up personal reserve accounts out of current profits – analogously to the shareholder equity accounts that existed prior to the simulated change of legal form. It will subsequently be possible to make shareholder-related dividend distributions out of these new accounts by passing a separate resolution or via an option to revert back to being taxed as a partnership.

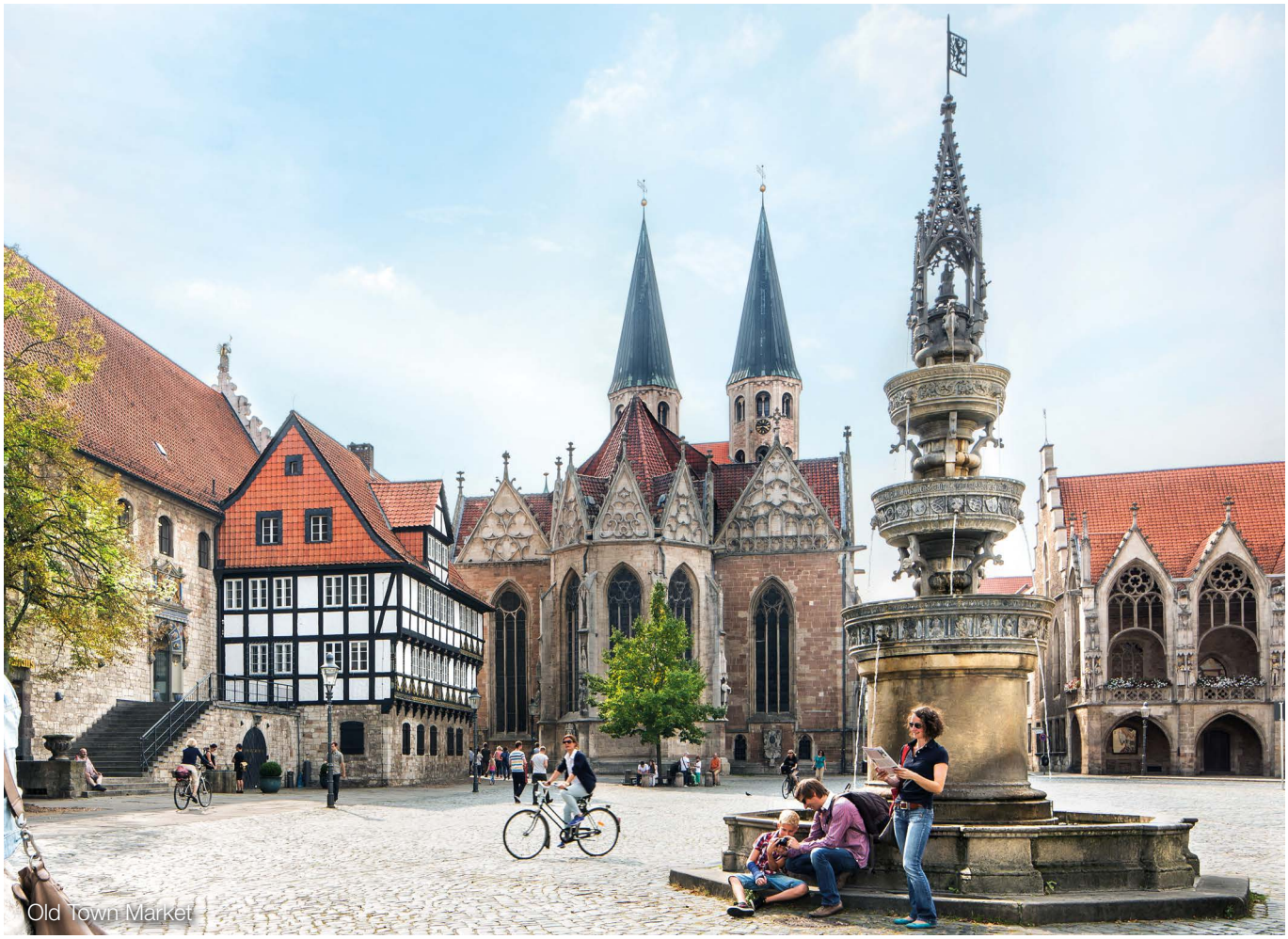
WP/StB [German public auditor/ tax consultant] Dr Matthias Heinrich/ RAin [German lawyer] Lena Wagner

Electricity tax – Withdrawal of self-generated electricity is subject to permission

Since 1.7.2019, under certain circumstances, operators of photovoltaic systems (PV systems) and combined heat and power plants (CHP plants) have already been able to withdraw electricity free of tax. The conditions for this should be reviewed because the principal customs offices have begun to systematically cross-check the core energy market data register and are asking operators to register their energy generation systems.

1. Background

Under the German Electricity Taxation Act, electricity is


Old Town Market

subject to electricity tax. This amounts to €20.50 per megawatt hour. It is an excise duty and becomes chargeable, in particular, when electricity is withdrawn for self-consumption or supplied to end users. However, electricity tax does not arise if the electricity is exempt from tax.

2. Tax-free electricity

The electricity that is exempt from tax is, in particular, that which is generated from renewable energy sources (PV systems) or in highly efficient CHP plants with an electric power output of up to 2 MW and which is withdrawn for self-consumption or supplied to end users in the vicinity of the system or plant (i.e., within a maximum radius of 4.5 km).

3. A permit for the withdrawal of tax-free electricity

A permit is required for the withdrawal of tax-free electricity, although the type of permit will depend on the power output of the system or plant. If tax-free withdrawal is not generally permitted then an official individual permit has to be applied for in order to be able to claim the electricity tax exemption. If there is no permit then the electricity that is generated has to be taxed. Depending on the size of the system or plant, a distinction has to be made as follows:

(1) PV systems of up to 1 MW and CHP plants with a power output of up to 50 kW – operators do not require a permit for the withdrawal of tax-exempt electricity because withdrawal is generally permitted (so-called general permission).

(2) PV systems and CHP plants with a power output of more than 1 MW and 50 kW up to 2 MW respectively – operators require a so-called official permit for the withdrawal of tax-exempt electricity in order to be allowed to withdraw the electricity free of electricity tax. The application for a permit has to be submitted to the principal customs office.

Conclusion

Operators of PV systems and CHP plants with a power output of more than 1 MW and 50 kW up to 2 MW respectively thus have to register their systems or plants with the competent principal customs office because it is solely in such circumstances that operators may withdraw electricity free of tax. Otherwise the withdrawal will be taxable and the tax will have to be paid.

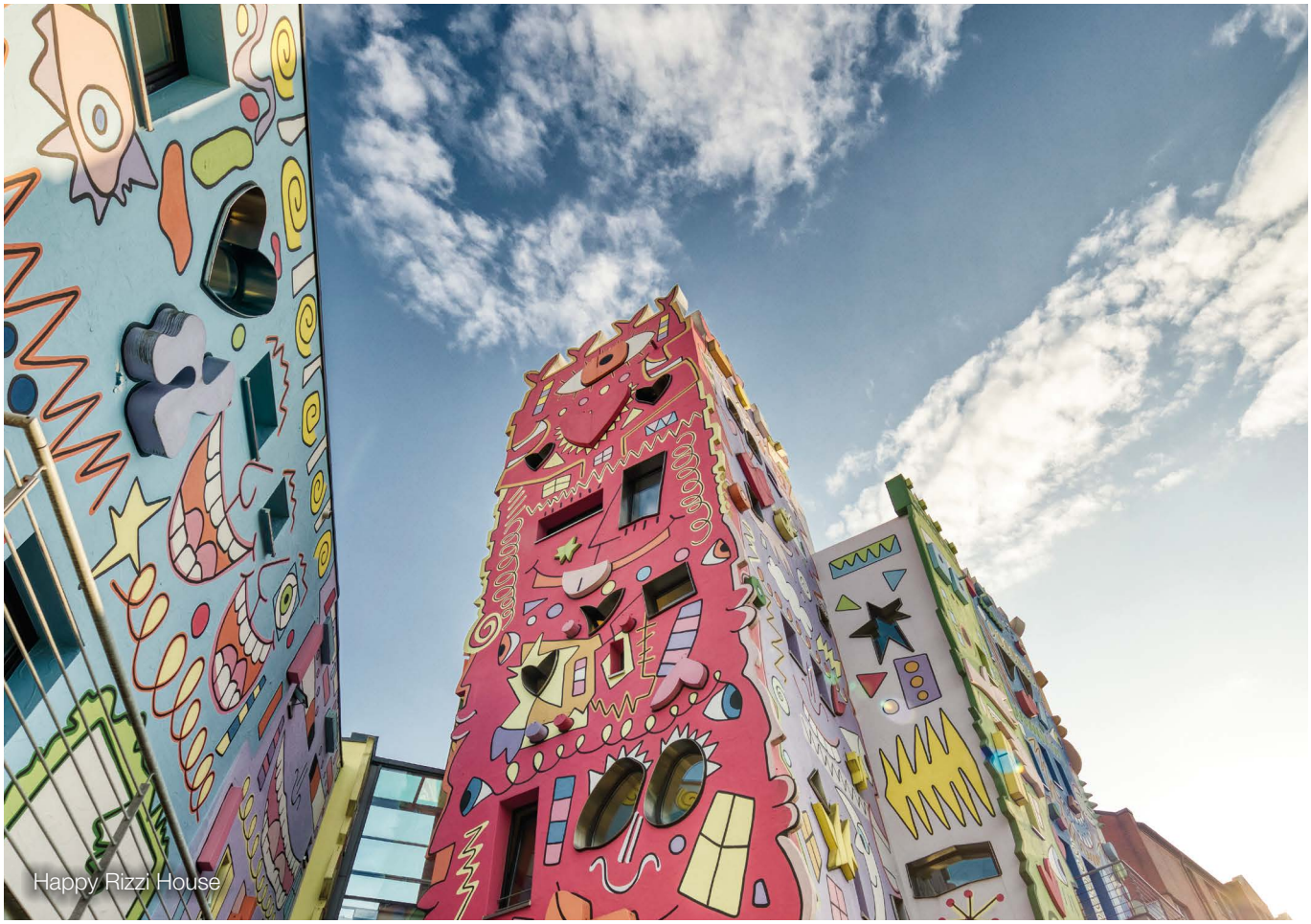
WP/StB [German public auditor/ tax consultant] Daniel Scheffbuch / Luca Gallus

An overview of planned tax changes, which in some cases will be applicable retroactively

On 23.2.2022, Germany's governing coalition introduced a 'relief package' in view of rising energy costs, inflation and the Russia-Ukraine conflict. Moreover, the German government's draft of the Fourth Coronavirus Tax-Related Assistance Act was passed on 16.2.2022. In the following section we present the most important changes.

1. Tax changes in the relief package

- **Elimination of the renewable energy levy** – The charge levied on electricity prices will be abolished as of 1.7.2022.
- **Higher standard deduction amount** – Retroactively increased as of 1.1.2022 by €200 to €1200.
- **Higher basic tax-free allowance** – The subsistence level for income tax purposes will be retroactively raised as of 1.1.2022 by €363 to €10,347.
- **Higher commuters' tax allowance** – From the 21st km of the commute to work it will now be possible to deduct €0.38 per km (instead of €0.35 per km previously) retroactively as of 1.1.2022.
- **One-off subsidies** – Recipients of 'unemployment benefit II', basic benefits and income support will receive a one-off payment of €100.
- **Direct child supplement** – Children affected by poverty will receive a direct monthly supplement of €20 as of 1.7.2022.
- **One-off heating cost subsidy** – Those who receive housing benefit and who live alone will receive a €135 subsidy in the summer (two-person households will receive €175); for each additional household member the subsidy will be increased by €35 in each case. Those in receipt of BAföG [a federal education assistance loan] such as students and apprentices will receive a €115 subsidy.
- **Increase in the minimum wage** – On 1.6.2022, the minimum wage will go up from currently €9.82 to €10.45. In a second step, the aim is to increase it to €12.00 as of 1.10.2022.



Happy Rizzi House

2. Planned changes to the Coronavirus Tax-Related Assistance Act

The Third Coronavirus Tax-Related Assistance Act already provided for an increase in the tax loss carry-backs for 2020 and 2021 to an amount of up to €10m or, in the case of a joint assessment for spouses, €20m. As a result, it became possible to carry back losses to 2019 and offset them there against positive income. Contrary to the expectation that the previous legal text relating to tax loss carry-backs would once again be applicable from 2022, the extended loss offsetting is now going to be prolonged until the end of 2023.

In the past, prior to the amendments of the previous Coronavirus Tax-Related Assistance Acts, it had only ever been possible to carry back losses to the year preceding the loss making year (one year loss carry-back). As of 2022, loss carry-backs will be permanently extended to two years and this will thus make it possible to carry back losses to the two immediately preceding years.

In addition, a number of provisions that were introduced for a time limited period will now be prolonged:

- The tax break for tax-exempt payments to top-up the short-time working allowance will be extended for three months and will thus apply to remuneration periods that started after 29.2.2020 and that end prior to 1.7.2022.
- The current provision on the home office blanket deduction will be extended by one year until 31.12.2022.
- The investment periods for reinvestments under Section 6b of the Income Tax Act (Einkommenssteuergesetz, EStG) and investment tax allowances under Section 7g EStG that expire in 2022 will be extended for another year.
- The option to depreciate non-current movable assets according to the declining balance method will be extended by one year, i.e., this would also be applicable for assets that were purchased or produced in 2022.
- The deadline for submission of tax returns for 2020 (in cases where tax consultants are engaged) will be extended by another three months up until 31.8.2022. For the returns in respect of 2021 and 2022, in cases where tax consultants are engaged, the deadlines will be extended by four months and two months respectively, whereby the deadline for submitting returns in respect of 2021 will be 30.6.2023.

Please note

Furthermore, the legislative package also includes the following new provision, namely, that employers who have made special payments in the amount of up to € 3,000 to employees who work at certain institutions, in particular hospitals, in recognition of their outstanding achievements in response to the federal or state provisions during the coronavirus crisis will obtain a tax exemption for these amounts.

Stéphane Schwedes, Expert-Comptable et Commissaires aux Comptes /
Carole Darbès, Avocate en droit fiscal

A further cut in the rate for French corporation tax for 2022

A corporation tax rate of 25% will apply to all companies in France for 2022. This year's cut thus concludes the gradual reduction in the corporation tax rate since 2016 from a rate that was originally 33.33%.

1. Exemptions may apply for SMEs

A reduced tax rate applies for small and medium-sized enterprises (SMEs). Companies with sales that do not exceed €10m have a corporation tax rate of 15% if their profits are no higher than €38,120. Profits that go beyond that level have to be taxed at a rate of 25%

In order to be able to benefit from the reduced tax rate, the company's capital would have to be fully paid up and at least 75% of the company or its French permanent establishment would have to be directly or indirectly owned by natural persons, provided that the group's consolidated sales did not exceed €10m.

2. No differences in the tax rate despite the €250m threshold

The tax rate for companies with minimum sales of €250m was 27.50% in 2021. Companies with sales below €250m

were subject to a tax rate of 26.50% in 2021.

The current tax rate (applicable since 1.1.2022) is 25% for all companies irrespective of their level of sales.

3. Other

A solidarity surcharge applies to companies whose corporation tax liability exceeds €763k and on the portion of the tax above this level it is charged at a rate of 3.3% of the liability.

The rate for the contribution based on the value added by the company (Contribution sur la Valeur Ajoutée des Entreprises, CVAE) was reduced as of 1.1.2021 from 1.5% to 0.75% of the value added by a company (accounting earnings before tax + personnel expenses + rent + depreciation and amortisation + other taxes + addition to provisions and valuation adjustments + interest expense).

4. Sample calculation

In a sample calculation where the taxable earnings constitute ¼ of the business value added, despite the reduction and from an economic point of view, the CVAE would represent 3% of earnings (0.75% / ¼). In this example, the overall CVAE rate would be 28.825% (25% + 3.25%).

ACCOUNTING & FINANCE

WPin [German public auditor] Julia Hörl / Sebastian Vor

Financial instruments – IBOR reform with accounting consequences under German GAAP and IFRS

LIBOR and EONIA were abolished in the course of the reform of benchmark interest rates (IBOR reform). This has implications not just for the respective financial instruments, but also for the associated accounting recognition. LIBOR-based products would then potentially have the problem that, on the reporting date, they would not have a valid reference rate and accounting for them would therefore become difficult.

1. The background to the reform

On international financial markets, reference rates such as LIBOR (London Interbank Offered Rate) and EURIBOR (Euro Interbank Offered Rate) play a major role in transactions between different banks. Loans, derivatives, securities and bank deposits with a variable interest rate component are usually aligned with the current fluctuating reference rate.

As these benchmark interest rates are considered to be vulnerable to manipulation and also to be non-transparent it was decided, on the basis the the EU Benchmarks Regulation (BMR) of 2016, that these types of benchmark interest rates should be superseded by replacements that are transparent and less vulnerable to manipulation, so-called risk-free rates – RFRs – or else alternative reference rates – ARRs.

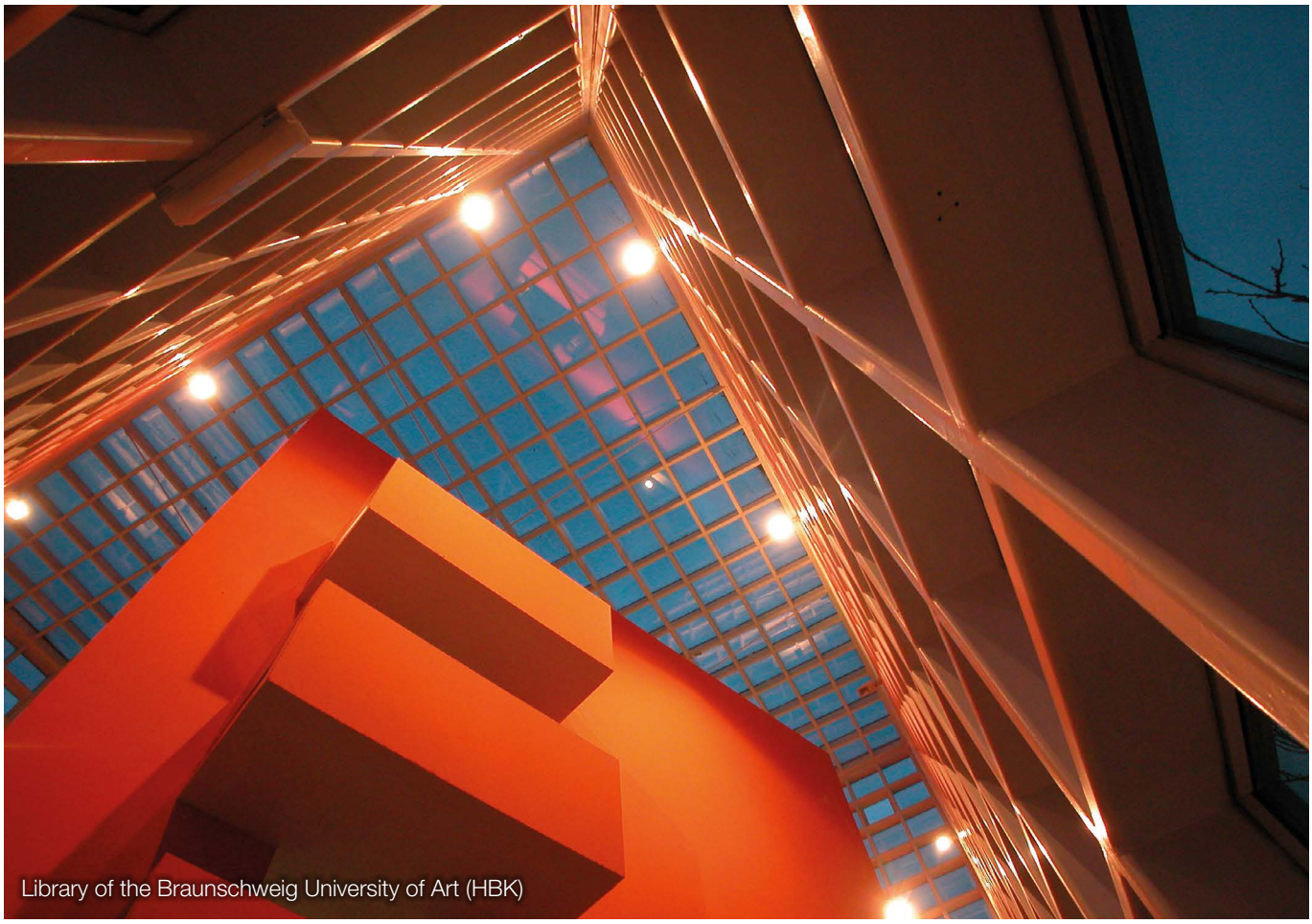
This reform is admittedly not about implementing new interest rates but rather about developing a more transparent method for calculating reference rates. This may however then have implications for the recognition of financial assets under German GAAP and IFRS if no new reference rate has been contractually agreed for the respective financial asset as at the reporting date. The standard setters have responded to this accordingly.

2. Adjustments to IFRS policies

The IASB divided the effects of the changes to reference rates on accounting into two phases. In the first phase, from September 2019, accounting issues were addressed that existed in the run-up to the replacement (e.g., recognition of hedging relationships). The second phase concerns issues arising at the time when a reference rate is replaced.

To this end, on 13.1.2021, the European Union published a Commission Regulation that endorsed the amendments to IAS 39, IFRS 9 and IFRS 7; these amendments became effective for financial years beginning on 1.1.2021. In addition, IFRS 4 and IFRS 16 were adjusted in relation to financial assets, financial liabilities and lease liabilities.

The aim of these amendments is to make it possible for


Library of the Braunschweig University of Art (HBK)

hedging relationships to continue despite the current uncertainties regarding the reform of reference rates. Accordingly, the amendments to the policy apply only for hedging relationships that are directly affected by a switch in the reference rate as well as for the reversal of cash flow hedge reserves, in order to avoid recycling to the profit and loss account.

In this connection, the IASB has issued an exemption, for a restricted time period, according to which a company may assume that the 'highly probable' criterion under IFRS 9 and IAS 39 will also apply for cash flow hedges where the reference rate will be replaced with an alternative reference rate. This will then be the case if the future hedged cash flows are 'highly probable'.

If there has not yet been a contractual adjustment for the respective hedging relationship where there is a new underlying reference rate then, as a result of the switch in the reference rate in a hedging relationship, there could be difficulties with the retrospective assessment under IAS 39. Such difficulties may arise when it can no longer be demonstrated that the effectiveness of the hedging relationship falls within the 80% to 125% range. This condition under IAS 39 has been suspended by the IASB – because of the associated uncertainty for the affected hedging relationships – until the uncertainty has been eliminated through adjustments to contracts.

If a change in the reference rate results in changed contractual cash flows then the carrying amount of the affected financial instrument should not be adjusted or derecognised but instead the effective interest rate should be updated. This would mean that a profit or a loss would not have to be immediately recorded. This relief applies only for changes that are a direct result of the IBOR reform.

3. Adjustments under German GAAP

The changes associated with IBOR reform to the preparation of financial statements in accordance with German GAAP (also referred to as the Commercial Code, *Handelsgesetzbuch, HGB*) relate to floating rate financial instruments, free-standing derivatives and hedging relationships in accordance with Section 254 HGB.

Reference rates are an essential feature of floating rate financial instruments. Insofar as their other essential features remain unchanged then there will be no change in their nature as floating rate financial instruments. In addition, the change in the reference rate leaves the legal and economic ownership of the floating rate financial instru-

ment unchanged with the reporting entity, whereby ultimately no change in the recognition of floating rate financial instruments arises.

According to the the principles for pending transactions, free-standing derivatives that are not recognised as a hedging relationship as defined in Section 254 HGB, generally, only have to be recognised if there is a risk that they will be a source of losses. However, a change in the reference rate to which the variable side of a derivative is tied will have no effect on the recognition of provisions for anticipated losses.

According to Accounting Standard 35 of the Auditing and Accounting Board (Hauptfachausschuss, HFA) of the Institute of Public Auditors in Germany *(Institut der Wirtschaftsprüfer, IDW)* – (IDW RS HFA 35) –, hedging relationships have to be dissolved if the hedged item and/or the hedging instrument are no longer recognised. A change in the reference rate does not result in a due date for or the derecognition of the hedged item and/or the hedging instrument. There are likewise no effects on the intention to hedge that arise from a change in the reference rate. Consequently, the hedging relationship will be maintained even after a change in the reference rate.

4. Implications for the disclosures in the notes to the financial statements

The following information will have to be provided for each reference rate that is relevant for a company:

- type and extent of risks in the context of the IBOR reform,
- company's progress with respect to the transition to alternative reference rates and
- description of the process for transitioning to the new reference rates.

Companies will be expected to provide quantitative data for hedging instruments where the switchover to a new reference rate is still outstanding. These should be disclosed separately according to:

- non-derivative financial assets,
- non-derivative financial liabilities,
- derivative instruments

If the change in the reference rate gives rise to any settlement payments then deferred expenses have to be recognised for these payments in accordance with Section 250 HGB and explained in the notes to the financial statements.

5. Conclusion

IBOR reform has increased documentation and procedural requirements for companies that hold financial instruments that are linked to reference rates. These will have to be examined on a company-specific basis.

It has been possible to stave off the undesirable effects of the IBOR reform on financial accounting by adjusting the regulatory basis. As a result of these adjustments it will be possible to take make the appropriate allowances for any accounting consequences and to evaluate them precisely beforehand.

Outlook

EURIBOR will also potentially be replaced by 2025 already. This will then likewise be a relevant issue for financial products that have hitherto been based on EURIBOR.

LEGAL

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

Tax pitfalls in the case of continuation clauses in partnership agreements

Partnership agreements usually include provisions in the event of the death of a partner (succession clauses). In principle, these provisions have priority over a partner's testamentary arrangements. Therefore, in this respect, corporate law prevails over inheritance law. However, the wording of a succession clause may also have inheritance tax consequences, as the following analysis of a Federal Fiscal Court *(Bundesfinanzhof, BFH)* ruling emphatically demonstrates.

1. Issue – Partnership agreement with a continuation clause

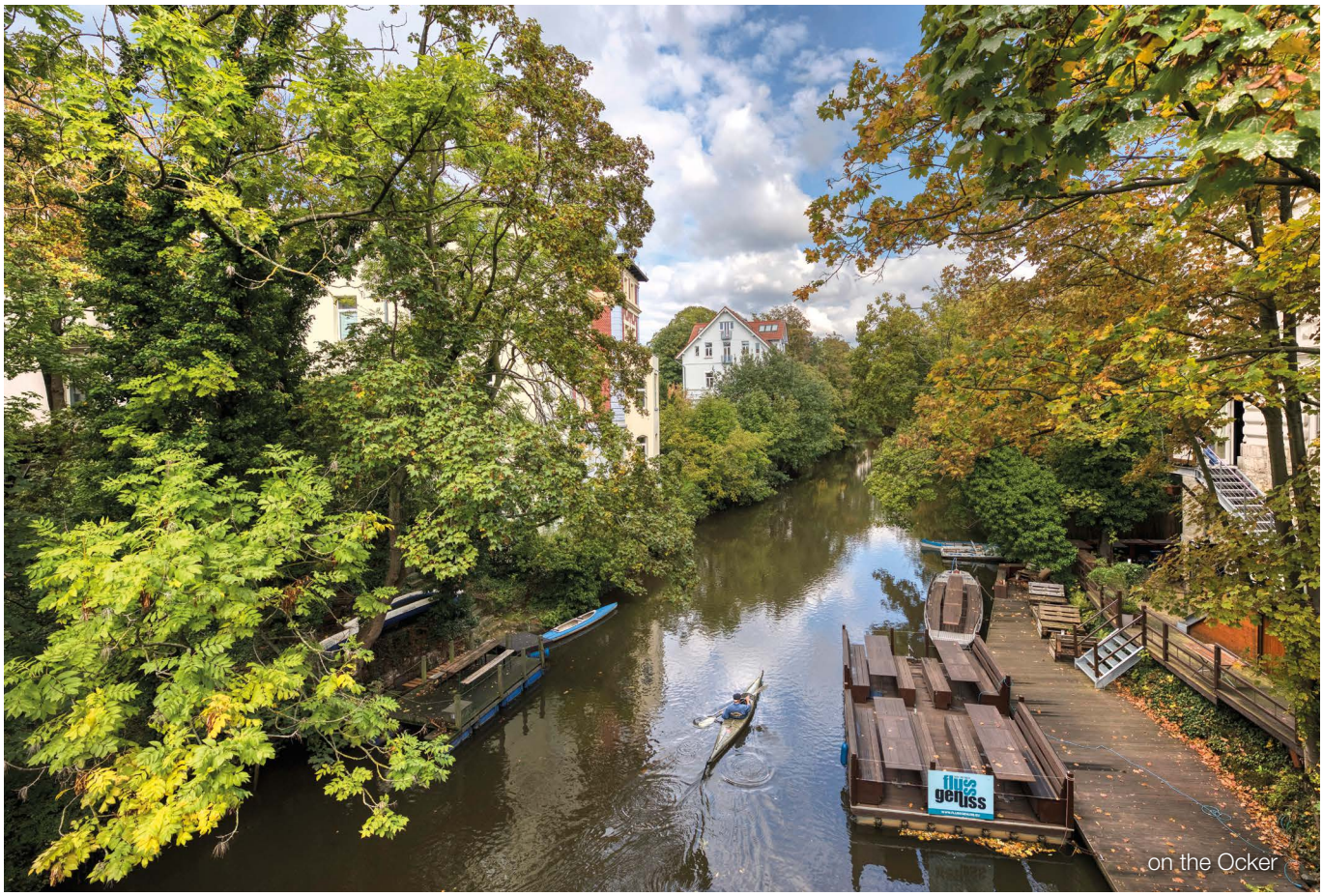
In the case in question, a partner in a commercially operating partnership had died and the partnership agreement contained a so-called continuation clause. This stated that the deceased partner would exit the company and that the company would continue with the remaining partners. As per the agreement, the legal heirs, who were here simultaneously the remaining partners, were entitled to the financial settlement that was even higher than the value of the deceased's partnership interest.

2. Inheritance tax treatment

The Federal Fiscal Court *(Bundesfinanzhof, BFH)*, in its ruling of 8.6.2021 (case reference: II R 2/19), clarified such a constellation as follows.

- The legal successors do not inherit the partnership interest since the deceased is yet to exit the company. They inherit the entitlement to the financial settlement that forms a part of the acquisition upon death that is liable to inheritance tax. This is a financial claim against the company that has to be recorded at the nominal value.
- A claim for a financial settlement forms part of the private assets of the legal heirs. This also applies even if the legal heirs are, at the same time, the remaining co-partners. That is why the inheritance tax exemption provisions for business assets may not be applied in this respect.
- The partnership stake of the deceased partner accrues proportionately to the remaining partners. This can constitute taxable gifting on death. Although this would apply solely if and to the extent that the financial settlement to be paid is less than the assessed value for tax purposes of the partnership stake – that was not the situation in the present case, but should normally be so. The exemption provisions for business assets could generally be used for this here.
- In view of the financial settlement that was 'too high, conversely, the heirs here wanted to claim a negative acquisition by accretion and offset it against the taxable financial settlement. The court however rejected this with reference to an unambiguous statutory provision.

Please note: It is generally recommended to ensure that the provisions in the partnership agreement and in the will are mutually compatible. In doing so, you should keep an eye on the tax consequences. In the case described above, it would have been significantly cheaper if the partnership agreement had permitted the partnership stake to be transferred to the legal heirs because then the exemption provisions would have been applicable.



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IN BRIEF

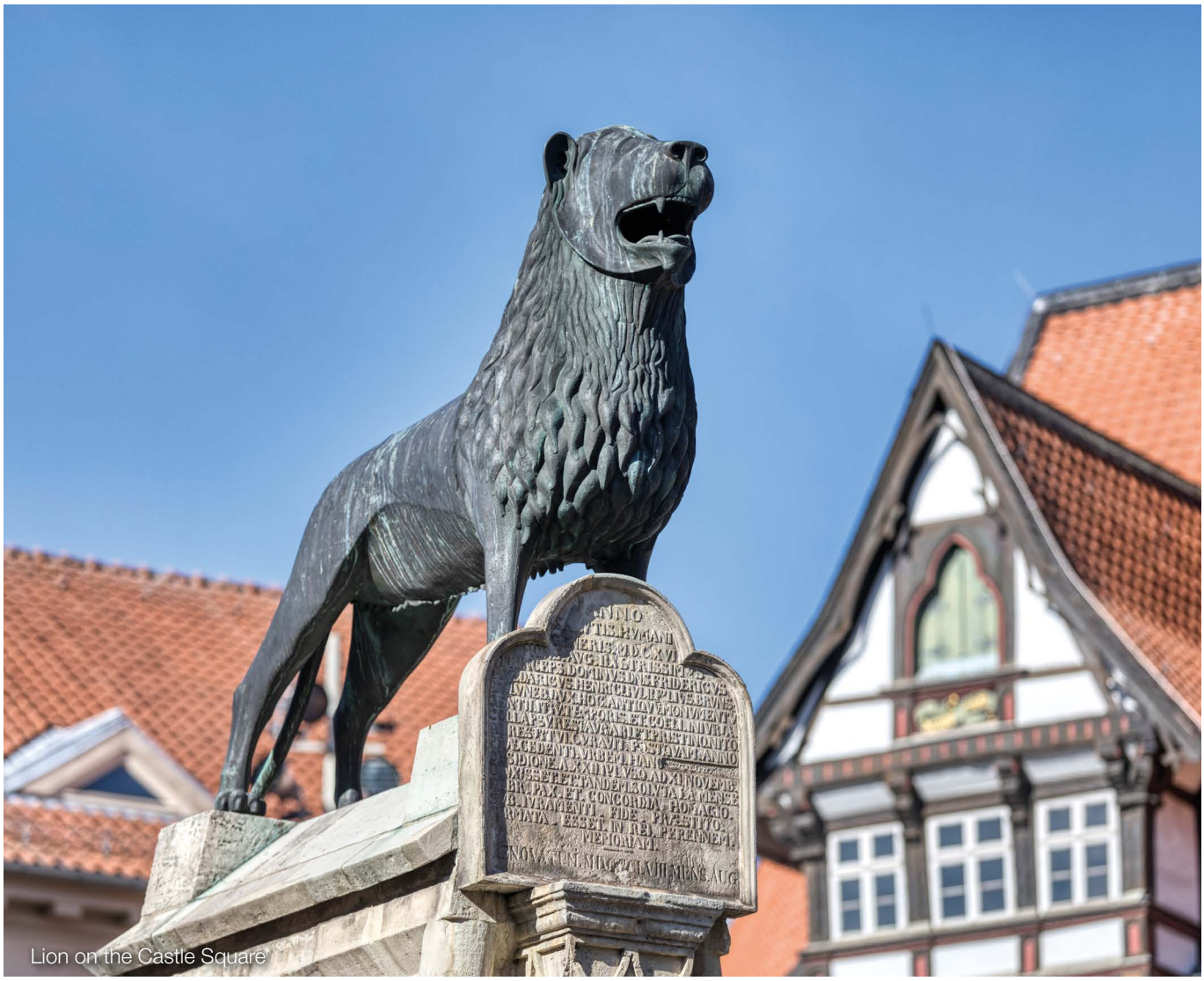
Cutting holiday leave after short-time working is permissible

The Federal Labour Court *(Bundesarbeitsgericht, BAG)* recently made a decision on the holiday entitlement after use has been made of short-time working – the ruling turned out to be employer-friendly.

The BAG, in its ruling of 30.11.2021 (case reference: 9 AZR 225/21), had to make decision about an employee who was working three days a week in sales. In 2020, she was repeatedly put on 'zero hours short-time working'. In April, May and October she was put on this status continuously and, in November and December, she worked on just five days altogether. That was why her employer was of the opinion that, for 2020, on account of the short-time working her holiday entitlement was only 11 1/2 days instead of the usual 14 days. The employee did not accept this and took legal action.

The BAG ruled that when the employer calculates the reduction they may include all the short-time working days where there was no obligation to work. The working time that was lost because of short-time working agreed by means of an individual contract cannot be equated with times where there is an obligation to work either under national law or EU law.

Outcome: Accordingly, in cases of 'zero hours short-time working', a part of an employee's holiday entitlement can be cut.



Lion on the Castle Square

Giving gifts to carers leads to a reduction in estate assets

If close relatives receive a high level of care during their lifetime then there is the possibility of giving gifts to the caregivers; these gifts then reduce the inheritance of those who would otherwise have been granted the equivalent value of these gifts.

The case that got to the Koblenz Regional Court (ruling of 18.11.2021, case reference 1 O 222/18, not yet legally binding) related to a married couple who, in 1996, had set up a will where they had initially mutually appointed each other as sole heirs and had designated their joint children as their final heirs. Furthermore, the will stipulated that one son would receive a property as an inheritance. However, following the death of the husband, the surviving testator gifted her co-ownership share in the property – which according to the will was actually meant to go to the son – to her daughter. In addition, a lifelong right of residence free of charge for the property was entered in the land register. Following the death of the mother, the siblings then disputed the lawfulness of this gift. The brother called for his sister to transfer the property to him and to authorise the cancellation of the right of residence.

However, the Regional Court dismissed the brother's case. The Court maintained that this was because there could only be a claim if the mother, as the testator, had made the gift solely to the detriment of the son's inheritance – this would thus have constituted an improper testamentary disposition. This could not be assumed in this case, since the testator had acted in her own interests.

Outcome: After the evidence had been heard, the Court reached the (not yet legally binding) conclusion that, both prior to the transfer as well as in return for the gift, the daughter had provided care services to a considerable extent.

A gift to a closely related person does not constitute a donation

The Federal Fiscal Court *(Bundesfinanzhof, BFH)* recently ruled on the connection between the deduction of donations against tax and gifts given to closely related persons. In view of the fact that the latter are not regarded as donations it is possible that constructive dividends could arise.

In its ruling of 13.7.2021 (case reference: I R 16/18), the BFH had to make a decision about the arrangements of a married couple devoted to art. They had founded a charitable trust and were the sole founders. The aim of the trust was to maintain artworks and, among other things, make them available on permanent loan to municipal galleries and museums. In this way, the objective of promoting art and culture was supposed to be accomplished.

In order for the trust to be able to fulfil its mission, the married couple donated a number of valuable works of art to their organisation and claimed a deduction for these as donations in their personal income tax returns. Besides the trust, both spouses also had a (non-charitable) corporation that, in turn, itself was the owner of the works of art. The married couple also arranged for this company, a GmbH [German limited liability company], to transfer its artworks to the trust in the form of a donation. To this end, the trust issued the appropriate donation receipts so that the GmbH would be able to deduct the donations in its corporation tax return.

However, a tax auditor for the GmbH took a different view of the situation. These gifts were not donations in the conventional sense, but rather constructive dividends for the married couple. The case against this was unsuccessful both before the competent Cologne tax court as well as the BFH. In the opinion of the judges, a constructive dividend can also arise if the pecuniary benefit goes not to the shareholders or partners themselves but, instead, to such closely related (even legal) persons. In this case, the trust could undoubtedly be identified as a closely related person.

Outcome: A constructive dividend arose here because this was the only way that the trust could pursue its actual objective and, moreover, not just small amounts of money – as unrelated third parties would likewise give – were donated.

AND FINALLY...

“A good work day starts with goals.”

Götz Werner, 5.2.1944 – 8.2.2022, German entrepreneur, founder and supervisory board member of the company dm-drogerie markt and its managing director for 35 years. Werner was moreover the founder of the “Unternimm die Zukunft” [embark on the future] initiative for unconditional basic income.

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