PKF

Newsletter

Key Issue

Withholding tax for construction services and its tax risks

05|23

Dear Readers,

The so-called reverse charge mechanism is an appropriate instrument for safeguarding VAT revenues. To this end, in the Key Issue section of the May edition of our newsletter we discuss the scope of application of **withholding tax for construction services** that could affect not only companies but also private individuals, for example, when PV systems are installed. After two decades, the German fiscal administration has now extensively revised the scope of application and this mechanism in a recent circular. Against the background of the risk of fines as well as liability risks, businesses are strongly recommended to deal with this topic area and to map it in the tax compliance management system (Tax CMS). Our second report in the Tax section is, once again, about **German tax groups for VAT purposes**, a subject that has engaged the Federal Fiscal Court in two recent decisions.

Next up, in the Accounting and Finance section, we discuss the modalities for the **energy price brake** for private households and businesses. We then direct our attention to the **building of assets with so-called exchange-traded funds (ETFs)** in a rising interest rate environment. Here, in this issue of our newsletter, our focus is on private investors; in June, we are going to consider corporate investors, particularly in view of the fact that when comparing the two categories of investors interesting differences can be seen in the taxation of income from (equity) funds.

In the Legal section, to begin with, we provide information on the first ruling on the issue of **COVID-19 compensation** in cases where employees were ordered to isolate in quarantine by an authority on the basis of the German Infectious Diseases Protection Act or as a result of the respective directive. In our second report we discuss a problem where a sole managing director passes away and there is no longer a managing director who is able to submit an updated **list of shareholders.** The third article in this section is likewise about what happens when a **managing director** is no longer there, however, here we consider if and for how long they can still be held liable.

We then continue our journey around the international PKF locations through the illustrations that break up the reports from our experts; this time we visit Copenhagen, where the PKF meetings for the Europe-Middle East region and International Tax (EMEI) will take place at the end of May.

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

Your Team at PKF

Front cover photo: Nyhaven, Copenhagen

Key Issue

Withholding tax for construction services and its tax risks

Contents

TAX

WP/StB [German public auditor / tax consultant] Dr Matthias Heinrich / StB [German tax consultant] Stephan Lüneburg

Withholding tax for construction services and its tax risks for businesses, lessors & Co.

The German fiscal administration recently revised its approx. 20-year-old circular on the application of withholding tax for construction services in consideration of a landmark ruling by the Federal Fiscal Court *(Bundesfinanzhof, BFH)*. Now, lessors and operators of PV systems that have construction work done could also be affected by the withholding tax for construction services. In particular, where the construction services are provided by foreign contractors, the recipients of those services in Germany need to be aware of their reporting and tax withholding obligations before payment.

1. The term 'construction services'

Construction services should generally be understood to mean any services for the purposes of the construction, restoration, maintenance, modification or destruction of structures. In order to answer a question that regularly arises in individual cases, namely, which works have to be classified as construction services, the Federal Central Tax Office *(Bundeszentralamt für Steuern)* has produced the 'Information leaflet on the withholding of tax in relation to construction work' (abbreviated in German to: *StAb-Bau-Merkblatt 2022*); this leaflet provides initial practical guidance (the English and German versions are available from the website of the '*Bundeszentralamt für Steuern*').

The BFH, in its ruling of 7.11.2019 (case reference: I R 46/17; constitutional complaint under case reference 2 BvR 1392/20 is pending) stated that the term 'structure' (*Bauwerk*) on which the construction services are carried out should be broadly interpreted. The Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* took this on board in its circular of 19.7.2022 (published in the Federal Tax Gazette 2022 I, p. 1229). According to that, structures are not just buildings but also all installations that are affixed somehow to the ground, or rest upon it by way of their own weight, that are created with building materials or building components by using construction tools and equipment.

Please note: Consequently, photovoltaic systems (on open land), shop fittings, display windows, restaurant equipment, illuminated signage, green roofs on structures or service connections to houses provided by power supply companies should also be regarded as structures.

2. Scope of application of the withholding tax for construction services

The aim of the withholding tax for construction services is to safeguard tax revenues for construction works by extending reporting obligations and deducting taxes at source. To this end, businesses, as recipients of construction services that have been carried out by German or foreign contractors have to withhold tax.

A recipient of construction services and, thus, the party liable to withhold taxes can also be a lessor. The installation/maintenance of PV systems on (family) homes by their owners likewise usually constitutes construction services.

Even foreign (general) contractors that do not themselves work as building contractors in Germany, - but invoice the recipient of the services for the works carried out by a subcontractor engaged to perform the work - as foreign businesses, have to withhold taxes in Germany for other foreign persons (Section 48(1) sentence 4 of the German Income Tax Act). There is a requirement to register with the tax office that has central responsibility for the respective country (e.g., for Spain this is the tax office in Kassel-Hofgeismar).

However, besides the withholding tax for construction services, including income tax, foreign building contractors also have to coordinate the payroll tax and VAT consequences.

Please note: In the private sphere, no tax needs to be deducted insofar as, e.g., a freelance journalist (thus someone who works as a self-employed businessperson) has their tiles replaced in their owner-occupied private residential property.

3. The withholding tax procedure and the consequences of non-payment

For construction services received in Germany, the contractor has to withhold 15% of the gross amount invoiced (the fee plus VAT minus any discount) and declare and pay this amount to the local tax office by the 10th of the following month. The date of payment by the recipient of the service is crucially important; the cash inflow for the supplying contractor or the date of the invoice for the construction works are not relevant. In the case of advance and final payments, an amount has to be already directly withheld.

If the declaration is not made within the prescribed time limit then the consequence could be a surcharge for late filing; if the tax is not paid within the prescribed time limit then late payment penalties may be determined. In the event of a failure to provide a tax return, the recipient of the service in Germany may be held liable via a notice of liability and administrative/criminal consequences could arise as a result of the failure to submit a return because submitting a withholding tax return has been put on an equal footing with submitting a tax return.

Please note: According to the above-mentioned BFH ruling of 7.11.2019, for the withholding tax for construction services, it generally makes no difference whether or not the construction services that were carried out are taxable as income in Germany.

4. Exemption from the withholding tax

An exemption from withholding tax will apply in cases of so-called 'small lettings' and solely for residential letting of not more than two properties. In the case of more than two residential lettings, no tax has to be withheld insofar as the value of the construction services that have been provided does not exceed €15,000 per calendar year. In all other cases the de minimis threshold level of €5,000 will be applicable.

In practice, the most frequent case of exemption from the obligation to withhold tax is if the supplying contractor presents an exemption certificate. For each payment, an exemption certificate that is valid at the time has to be provided to the recipient of the services (a clearly legible copy, or one that is sent electronically), so that there is no withholding obligation with potential liability. The recipient of the services has to check that the scope of the certificate is not restricted to a specific construction service and that it has been affixed with an official seal and bears a security number. The recipient of the services is also able to check the validity of the certificate by submitting an online inquiry via the EIBE Portal on the website of the 'Bundeszentralamt für Steuern'.

The recipient of the services is required to retain the exemption certificate it receives for six years. It is not sufficient for a service provider to merely refer to the existence of such a certificate (e.g. when an invoice is subsequently issued).

A Rococo ensemble - The Amalienborg Royal Palace

5. Implementation in a tax controls system

In order to meet the requirements for the withholding of tax in relation to construction work, we would recommend mapping the process within the scope of the tax compliance management system (Tax CMS) at the company level since that is where information will be available about construction services that have been provided including the payments. The fiscal administration will attach great importance to such a Tax CMS with regard to its assessment of the actions of a company's executives and whether or not these were wilful or negligent.

Please note

Furthermore, a controls system that has been checked and, in the context of an external tax audit, found to be effective by the fiscal administration could result in this audit field no longer being audited by the fiscal administration in the future. This change came into force on 1.1.2023 (Art 97 Section 38 of the Introductory Act of the German Fiscal Code within the framework of DAC7).

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

Developments as regards German tax groups for VAT purposes

We have had no less than two rulings on German tax groups for VAT purposes within a short space of time. For one thing, the Federal Fiscal Court *(Bundesfinanzhof, BFH)* has changed the criteria under which it would accept that financial integration exists. Furthermore, the BFH has referred to the ECJ for a preliminary ruling on the question as to whether the sales between members of a VAT group (intra-group sales) are indeed not subject to VAT.

1. Pre-conditions and legal consequences of a tax group

A tax group for VAT purposes requires a controlled company (subsidiary company) to be integrated - within the actual overall circumstances - financially, economically and organisationally into the company of a controlling, economically active entity (parent company). If a tax group exists then the parent company will be liable to pay the

The famous Tivoli Gardens amusement park

VAT on the transactions of a subsidiary company. Furthermore, the fees that are paid in the context of exchanges of services between members of the tax group are, at least under existing German legislation, not subject to VAT; such members are regarded as parts of a unified company.

2. New perspective on financial integration

The view hitherto taken in German case-law and by the fiscal administration in respect of financial integration was that a corporate entity had to hold a majority of the voting rights of the controlled company as a pre-condition for this type of integration. The BFH, in its ruling of 18.1.2023 (case reference: XI R 29/22), now accepts that there can be financial integration even if the corporate entity holds just 50% of the voting rights of the controlled company, but is nevertheless able to impose its will because it has a majority shareholding in the controlled company and the entity in question is the sole managing body of the controlled company. This adjustment was based on a preliminary ruling from the ECJ (of 1.12.2022, case: C-269/20), according to which the pre-condition for the above-mentioned transfer of the tax liability to the parent company should not explicitly be holding a majority of the voting rights, but rather

- the need to be closely bound to one another by financial, economic and organisational links,
- the avoidance of tax losses and
- the entity being in a position to impose its will on the controlled company.

3. Could VAT potentially be applied to intra-group sales after all?

The ECJ, in its above-mentioned preliminary ruling, stressed that a tax group for VAT purposes should not entail a risk of tax losses. While a subsidiary is liable for the parent company's VAT, nevertheless, Germany's supreme fiscal court fears that VAT losses as a consequence of VAT groups could be generated in a different way. For example, if an entity is active in the areas of banking/insurance, healthcare/social services, education or lets out residential properties and, in doing so, generates VAT-exempt sales without being able to fully deduct the input tax then, for this entity, the inputs procured from a subsidiary company might lead to more favourable VAT consequences than if the respective inputs were procured from an organisation that is not regarded as a subsidiary company. Against this backdrop, the BFH has referred the following question back to the ECJ:

- are intra-group sales within a tax group not actually relevant for VAT purposes or
- would, at least, something different apply if the recipient of the goods or services was not entitled to a full input tax deduction (ruling of 26.1.2023, case reference: V R 20/22).

Please note

If the ECJ decides that the German legislation is not in line with EU law then, in specific cases, there could be huge repercussions where there is no full input tax deduction for VAT group members that are the recipients of goods or services and this would open up structuring potential.

ACCOUNTING & FINANCE

Swen Lepperhoff

Relief provided by the energy price brakes

The German government introduced 'energy price brakes' in response to the sharp increases in energy prices and the enormous economic burdens associated with them. As of this year, these 'brakes' have the effect of reducing the high costs for electricity, gas and district heating, within certain thresholds, for businesses and private households.

1. Scope of application for the relief

The relief has been applicable since March. For businesses and private households this relief has already been applied retroactively to cover January and February. Generally, no application needs to be filed in order to get this relief. However, to get higher amounts of relief, businesses are obliged to provide information that is relevant for state aid to their energy suppliers or the competent authority. If any uncertainties arise in the group of companies during the collection of the relevant data then this could considerably hamper the estimation of potential energy price brakes for the liquidity plan and the determination of the upper limits under state aid rules.

The 17th-century stock exchange - a distinctive symbol of Danish economic power

2. Technical implementation

Within the framework of the energy price brakes, from January 2023 to April 2024, the costs incurred for electricity, gas and district heating are capped at a certain price level. The amount of relief then results from the difference between the agreed energy rate and a statutory reference price. The amount of relief is limited to between 70 % to 80 % of the consumption in 2021, or the forecast consumption in 2023. The resulting amount of relief is granted by directly offsetting it in the respective electricity and gas bills. For businesses who receive relief in an amount of more than €2m, by way of the price brakes or other types of state aid, this difference will be capped at specific amounts. The price brakes for district heating are based on the provisions of the price brake on gas.

3. Upper limits under the state aid rules

As regards the subsidies, requirements under state aid rules and, thus, the upper limits defined by the EU Commission have to be complied with. These upper limits will be based on the crisis-induced additional costs for energy during the period from February 2022 and April 2024 as well as the absolute maximum limit of €4m for businesses that are not particularly affected.

Please note: Businesses that are particularly affected will be able to avail themselves of higher amounts of state aid. A business will be deemed to have been particularly affected if the decline in its EBITDA in 2023 when compared with its EBITDA in 2021 is at least 30%. In this case, it is relevant that the upper limits under the state aid rules do not relate to the separate businesses, but always to the entire group of companies. Therefore, if applicable, there will have to be an allocation between the separate businesses in the group.

4. Reporting obligations

Depending on the amount of the monthly relief, some businesses may be obliged to report various matters related to state aid rules. There is a general reporting obligation for businesses whose monthly amount of relief exceeds an overall amount of €150,000. If the amount of relief exceeds - possibly even in a group of companies - a relief sum of €2m during the entire eligibility period then other mandatory reports will have to be submitted. The suppliers should generally have been notified of any expected applicable upper limits and of how the amounts of relief should be allocated to different connectors by 31.3.2023. The final upper limits then have to be communicated to the suppliers by the end of the year. Insofar as the requisite information will only be available at a later date, the report will have to be made without delay.

Please note: Breaches of the obligation to notify constitute a regulatory offence and could lead to the imposition of a considerable fine.

5. Reflecting the energy price brakes in the financial projections

For an accurate and reliable liquidity plan as well as for determining the upper limits under the state aid rules it will be necessary to collect the relevant data. Inaccurate and corrupt data can result from, for example, interactions and synergies in the group of companies that have continued to be disregarded. For energy intensive businesses, in particular, ensuring that the relevant data that is collected is as accurate as possible is of crucial importance.

Adrian Tammen

Building private assets with ETFs during a period of rising interest rates

The effects of compound interest while building assets are mainly impacted by the tax implications. This report discusses the consequences of rising interest rates for ETF investors that should be considered. In the following section here, we first take a look at private investors. In the next issue of this newsletter we will examine the impacts of investments in business assets.

1. Income from investing in ETFs at the fund level

According to the consensus among finance academics, there is a growing number of private investors who are building assets for the long term with maximum diversification and minimum costs by participating in the global equity market. In doing so, they frequently draw on so-called exchange-traded funds (ETFs) that, because of their structure, are usually cost-effective and facilitate flexible investment opportunities without forfeiting diversification.

At the same time, many ETFs track a specific index whereby a basket of securities are held that form the basis of an index and are similarly weighted. The question that needs to be asked here is whether the net income that accrues in the ETF is distributed in the form of dividends or interest paid to investors, or whether it is accumulated.

Please note: Frequently, an ETF will thus offer distributing and accumulating alternatives (so-called 'sister ETFs).

2. Income from investing in ETFs at the personal level

A separate analysis of the fund and investor levels was made possible by the 2018 German Investment Tax Reform Act under which, for taxation purposes, the transparency principle was replaced by the separation principle. According to that, investment income at the personal level, pursuant to Section 20(1) no. 3 of the Income Tax Act *(Einkommenssteuergesetz, EStG)* is subject to withholding tax plus the solidarity surcharge. The Investment Tax Act *(Investmentsteuergesetz, InvStG)* differentiates here, according to Section 16(1) InvStG, between distributions (no. 1), capital gains (no. 3) and pre-determined tax bases (no. 2). While the first two above-mentioned types of income relate to actual cash inflows at the investor level, the pre-determined tax basis constitutes non-cash income; the latter category was introduced with a view to equalising the tax treatment of distributing and accumulating sister ETFs or funds. The basis for this notional income - which can be deducted if a capital gain is realised - is the rate of return that is specified in Section 18(4) InvStG and has to be modified as well as published annually by the Federal Ministry of Finance in the Federal Tax Gazette (Bundessteuerblatt) at the start of each calendar year.

3. Low interest rate phase has been replaced ...

As a consequence of the phase of sustained low interest rates, the relevant rate of return before modification was 0.87 %, 0.52 % and 0.07 % respectively for the years 2018-2020. The low point was reached in 2021 and 2022 with a rate of 0.00 %. Low interest rates on the bond markets cannot however be compared with low dividends on the equity market. In the 2018-2020 period, accumulating funds were thus able to benefit from tax privileges on account of lower or no income at the investor level when compared with the distributing alternative because, in the latter case, tax implications were triggered, at least, where distributions exceeded the flat-rate savers' allowance. Overall, a pre-determined tax basis that is lower than the distribution by the sister ETF makes it possible to generate positive interest effects if the flat-rate savers' allowance has, at any rate, been systematically exhausted.

... by the current higher interest rates

In 2023, the relevant rate of return before modification rose to 2.55%. The tax consequences will only have an effect on the first working day in 2024. Nevertheless, when interest rate levels are rising it is possible to achieve full tax parity with sister ETFs as well as with funds in general.

Currently, it is therefore no longer possible to achieve positive interest effects on a regular basis by opting for accumulating ETFs. However, nor will any disadvantages arise from retaining income either.

4. Result for private investors

During the 2018-2022 period, it became clear that due to the structure of the pre-determined tax basis, at least when the interest rate level is low and equity market returns are moderate to high, positive interest effects are possible by investing in accumulating securities. In this case, the only, but calculable, risk is that the flat-rate savers' allowance cannot be exploited in the same way as for distributions. In the current environment of rising interest rates, no disadvantage is however expected when compared with distributions if the pre-determined tax basis reaches or exceeds the distribution rate.

LEGAL

RAin [German lawyer] Maike Frank

First ruling on COVID-19 compensation

Since 2020, employers have been able to apply for compensation for the loss of earnings incurred by employees who had to isolate in quarantine at home. In doing so, a number of applicants have been refused pay-outs by the compensation authority. The first rulings on the legal actions that were subsequently brought have now been issued.

1. Background to the disputes that have arisen

If, on the basis of the Infectious Diseases Protection Act *[Infektionsschutzgesetz, IfSG]* or the respective directive, an employee is officially ordered to isolate in quarantine and, as a result, incurs a loss of earnings, their employer is able to claim compensation for the relevant time period. This is initially calculated on the basis of the amount of the loss of earnings.

The Infectious Diseases Protection Act provides for the employer to first pay the employee the amount of compensation and then apply to have it reimbursed. If the competent authority refuses to reimburse the amount then the employer can appeal against the refusal before the competent administrative court. The reason that is frequently provided for refusing an application for a compensation payment is that the loss of earnings that arose was either not at all because of or not due to having to isolate.

2. How a loss of earnings that has to be compensated originates

Under employment law, the "no work, no pay" principle generally applies - those who do not perform any work will also not be entitled to any remuneration. There are exceptions to this that provide for employees, in certain cases, to be able to claim their wages (or compensation payment) from their employers even if the employees are not able to do their work. For example, wage and salary payments during a period of illness would constitute benefits in lieu of income. In such a case, the loss of earnings that occurs is not due to having to isolate but due to illness. The entitlement to compensation that emanates from the IfSG would then not apply because it would fail to satisfy the criterion of loss of earnings that occurred 'as a result of' (due to having to isolate). The payment would be made under the Continued Payment of Wages and Salaries Act.

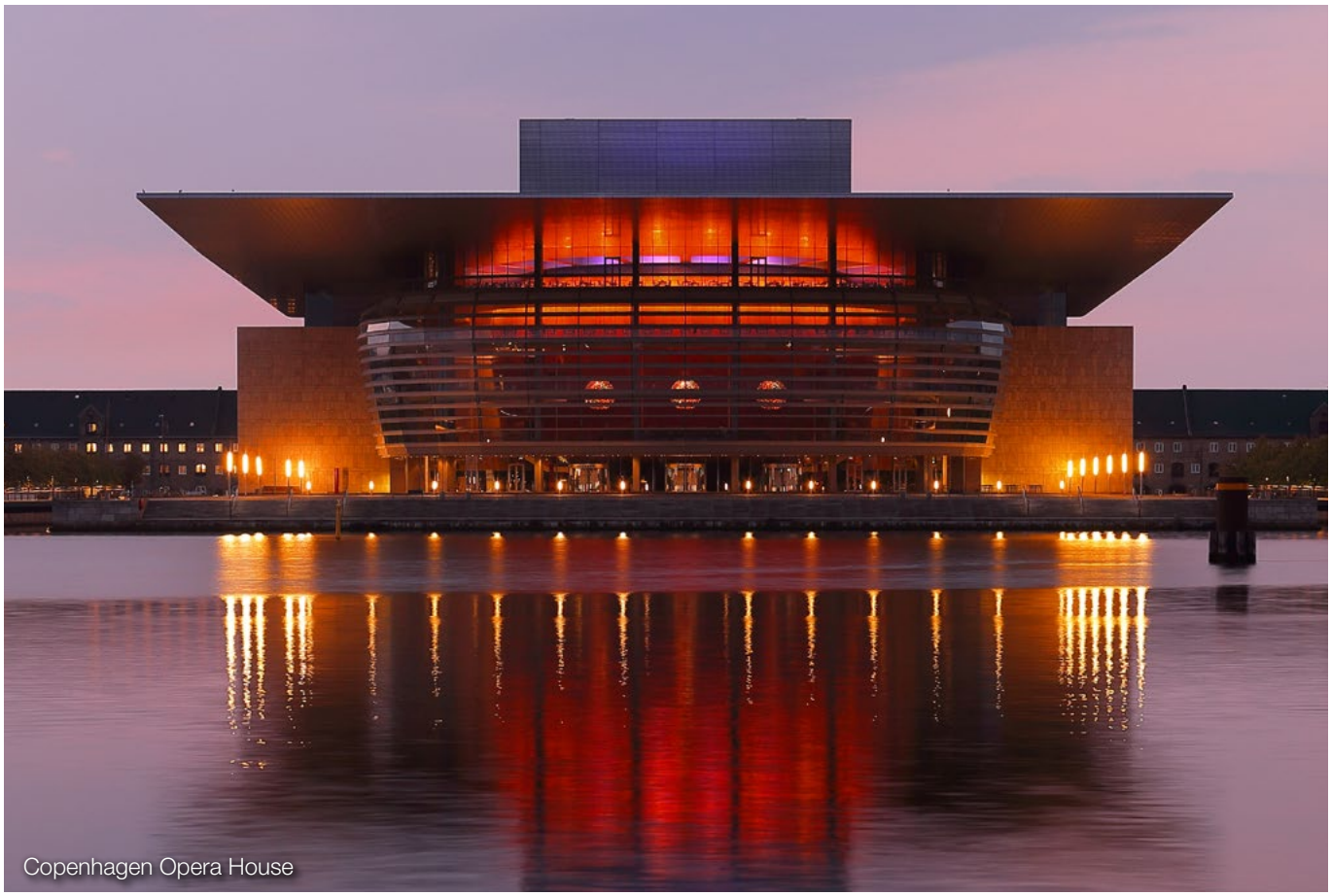
Another regulation that constitutes an exception to the "no work, no pay" principle is Section 616 sentence 1 of the Civil Code *(Bürgerliches Gesetzbuch, BGB).* This stipulates that an employee retains their entitlement to remuneration even with 'no work' if: "for a relatively insignificant period of time, for a reason that is attributable to the employee personally, through no fault of their own they are prevented from performing their duties". Insofar as the employer would have to continue paying wages under this regulation then the employee would precisely not incur a loss of earnings so that the entitlement to compensation under the IfSG would then also not apply. For employers, the legal disputes were therefore about clarifying that Section 616 BGB did not apply.

It was (and is) thus questionable - and a major point of contention - if and when the conditions under Section 616 sentence 1 BGB are met. The "reason that is attributable to the employee personally" does not usually cause any problems; in the case of having to isolate, normally, the reason is individual risk of infection. The employees generally bore this risk through no fault of their own insofar as they had complied with the hygiene regulations.

However, due to the lack of a definition of "a relatively insignificant period of time" there have been fierce disputes about what period of time can still be regarded as being insignificant - what periods of absence are thus short enough in order to establish an entitlement to remuneration under Section 616 sentence 1 BGB so that it could be deemed that there was no loss of earnings. However, in the legal literature and court decisions, time periods ranging from a few days and up to six weeks have been discussed. To some extent, the time period should also be set in relation to the duration of the existing employment relationship, i.e., in cases of long-standing service, a longer period of time (e.g.,14 days) could still be "relatively insignificant" (and therefore remunerated by the employer under Section 616 sentence 1 BGB). It has also been discussed that, irrespective of the period of service, only short periods of absence should be included under Section 616 sentence 1 BGB during which, for one or a few days, employees would be prevented from doing their duties because of, e.g., accidents in the family, weddings, births or urgent appointments at government offices. At any rate, there is agreement that not even partial entitlement would arise if, from the outset, the period of time is insignificant. Up to now, there have been hardly any court rulings that could resolve the dispute discussed above, in any case, not on the instances of having to isolate, usually for 14 days, in connection with the COVID-19 pandemic. Another feature of these proceedings was that administrative courts have had to grapple with profound employment law issues.

3. Decisions of the courts of first instance

In the meanwhile, the first rulings in this connection are available (Administrative court in Münster, rulings of 1.12.2022, case references:5a K 92/22, 5a K 165/22, 5a K 5797/21, 5 K 106/22, 5 K 156/22 and 5 K 164/22). In this respect, the court positioned itself to the effect that twelve days of isolation can no longer be regarded as "a relatively insignificant period of time" so that the conditions under Section 616 sentence 1 BGB cannot be fulfilled and, therefore, the court affirmed that there had been a loss of earnings that had to be compensated. The rulings are legally binding to some extent. However, in some cases, appeals have been lodged. It remains to be


Copenhagen Opera House

Rosenborg castle on the edge of the King's Garden, or 'Kongens Have'

seen whether or not the appeal court confirms the above decisions.

4. Recommendation

Disputes with authorities about these issues can be avoided if, in their employment agreements, employers ensure that Section 616 sentence 1 BGB is excluded from the outset for cases of official isolation and quarantine orders. It should however be borne in mind that, under employment law, it is not possible to effectively exclude Section 616 BGB in its entirety, but instead, only under certain circumstances.

Please note

It is possible to apply for compensation in connection with a quarantine directive within a period of two years following the issue of a prohibition notice with an instruction to stop work.

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

The list of shareholders of a GmbH – A potential source of succession problems

In the business sphere, a death could pose an existential threat, particularly if there has been no structured succession planning and no succession policy has been put in place. Besides, by neglecting this, even supposedly trivial issues - such as, updating the list of shareholders in the case of a GmbH *[private limited company]* - could moreover lead to serious difficulties.

1. Problem statement

The list of shareholders of a GmbH provides information on the shareholders and the exact ownership structure. This is maintained in the commercial register and it is basically the responsibility of the management to keep the list up to date if no notary is involved. Since the 2008 GmbH reform, this has been of special importance because only shareholders whose names have been entered in the list of shareholders are able to effectively exercise their shareholder rights vis-à-vis the GmbH, thus able to participate in the adoption of resolutions or receive profit distributions (the so-called legitimising effect). This would also apply in the event of the death of a shareholder. A deceased shareholder's heirs may only exercise their shareholder

rights vis-à-vis the GmbH once their names have been entered in the list of shareholders.

A genuine dilemma can arise from such a situation, in particular, where there is a sole shareholding managing director. This is because, on the one hand, with the death there will be no managing director any more who would be able to submit an up-to-date list of shareholders. Moreover, on the other hand, the heirs would not be able to pass a resolution to appoint a new managing director since their names would not have been entered in the list of shareholders.

2. A temporary managing director for the emergency

However, there is no clear line among the courts as to how such a dilemma can be solved. One option is for the register court, upon request, to appoint a temporary managing director for the emergency who can then submit an amended list of shareholders. Yet, even that is not unproblematic, as a decision by the highest state court for the city-state of Berlin *(Kammergericht)* of 23.11.2022 (case reference: 22 W 50/22) demonstrated. In the case in question, the life partner of the deceased, upon her own request, was appointed a temporary managing director for the emergency. The complaint that was made against this by the heirs who disagreed was unsuccessful and was rejected by the court with a reference to the fact that their names were missing from the list of shareholders.

3. Precautionary measures

The best way to prevent the problems outlined above is to appoint another managing director during the lifetime of the first one so that, in an emergency, the company would be able to continue functioning. The scope of functions for the additional executive can, initially, be restricted and be typical of functions that would be required in an emergency situation.

Besides, with respect to the shareholding in the company, it would be advisable to grant a power of attorney so that there would, at least, be clarity with regard to the material authorisation to exercise shareholder rights.

Additional note

Individual shareholders of the GmbH are entitled to have their correct details included in the list of shareholders. However, they cannot demand this of a company's executives but rather of the company itself. This was recently decided by the Federal Court of Justice in a landmark ruling of 8.11.2022 (case reference: II ZR 91/21). This applies both to the right to have the list amended as well as the preventative requirement of refraining from submitting an incorrect list of shareholders

A managing director's liability after leaving the executive board?

If a GmbH [private limited company] ceases to comply with certain obligations, such as, e.g., transferring the payroll tax, then the local tax office *(Finanzamt, FA)* can also hold the managing director liable for this. If there are several managing directors, then the FA can decide which of them it will hold liable and to what extent. In the case in question, the Düsseldorf tax court had to determine whether or not the competent FA had exercised its discretion properly here.

1. Issue

In the case on which the Düsseldorf tax court ruled, of 18.11.2022 (case reference: 3 K 590/21 H), the claimant was the sole managing director of B-GmbH in which E also held a stake. The claimant's managing director's contract had been for a fixed term until 30.6.2019. On 15.4.2019 the claimant as well as E and A (the managing director of C-GmbH) wrote a letter of intent. According to that, C-GmbH intended to acquire a majority stake in B-GmbH. In the course of this, A and E were supposed to become managing directors and the claimant a consultant, as of 1.7.2019. At the same time, a shareholders' resolution was drawn up according to which A and E were appointed managing directiors as of 1.5.2019 and 1.7.2019 respectively. E left the GmbH under a notarial agreement of 15.4.2019 and C-GmbH became the majority shareholder of B-GmbH. The entry in the Commercial Register, even after the 30.6.2019, stated that the claimant alone was the managing director. On 23.3.2020, insolvency proceedings pertaining to the assets of B-GmbH were opened. In an assessment notice of 2.6.2020, the FA held the claimant liable for the payment of payroll tax arrears since, according to the excerpt from the Commercial Register, he had been appointed as the managing director for the liability period of June to December 2019.

2. Decision

The legal action, before the tax court, of the claimant who had been held liable was successful because a managing director's function ceases upon their dismissal. This will apply irrespective of when the termination of the function is entered into the Commercial Register. Therefore, the claimant's managing director function ceased after the 30.6.2019. While there was no separate shareholders' resolution for this, nevertheless, the resolution of 15.4.2019 could be interpreted in that way. This resolution was effective and did not need to be certified by a notary. The fact that the claimant had still signed documents after 30.6.2019 was unimportant. From this perspective, he was merely operating as a representative without the power of representation. As of 1.5.2019, A was exercising the function of managing director.

Outcome

In the opinion of the Düsseldorf tax court, the FA's discretionary decision was wrong because there were still other managing directors who could have been held liable..

IN BRIEF

Where would a financial settlement be taxed following a move to a foreign country?

When a move to a foreign country follows the termination of an employment relationship a question that arises is which of the two countries will have the right to tax. In the case in question, a financial settlement was taxed in Germany even though the claimant, according to his own statements, was already living in the UK.

The claimant had been employed in Germany. His employment relationship was terminated as of 30.9.2016 by mutual agreement. A financial settlement was agreed as compensation, however, this was only supposed to be paid out on 31.1.2017. The claimant deregistered his residence in Germany as of 21.10.2016. On 15.12.2016, the German embassy in London certified a copy of his passport pursuant to which the claimant was no longer domiciled in Germany but in the UK. The financial settlement was paid out to the claimant on 30.1.2017 without any payroll tax deduction because he had applied for the appropriate certificate from the local tax office. In his application he had stated that he wanted to live in the UK from 31.10.2016 and that the financial settlement was taxable there. However, the local tax office cancelled the exemption certificate that it had granted because it had been issued unlawfully and subsequently demanded payment of the payroll tax.

In the opinion of the Münster tax court (ruling of 23.8.2022 – 15 K 791/19 L) the claim was unfounded. The local tax office was able to cancel the certificate retroactively. The financial settlement that was paid led to income that was subject to limited taxation and, despite the place of residence being in another country, the income was subject to the deduction of payroll tax in Germany. The judges were not able to establish that, after ceasing his work in Germany, the claimant had been deemed to be a tax resident in the UK. He had not provided a certificate of tax residence from the UK authorities. Under UK law, simply having an address would not be sufficient to be deemed a tax resident. Yet, even tax residency in the UK would not hinder taxation in Germany. Germany's right to tax is not restricted by the law.

Tax-reducing provision for age-related free time

Businesses that give their employees additional days off from work in the form of age-related free time can create tax-lowering provisions for this.

The Cologne tax court, in its decision of 10.11.2021 (case reference: 12 K 2486/20) had to rule on employees who, under the framework agreement on general working and employment conditions, were entitled to additional paid free time of two working days for each full year of their period of service if they had worked for the business with-

out interruption for at least ten years and had reached the age of 60 years. In the course of a tax audit, the local tax office had refused to accept the (tax-reducing) provision for liabilities of uncertain timing or amount that had been created for this because the requirements had not been satisfied. According to Section 249(1) of the German Commercial Code, provisions may only be created for liabilities of uncertain timing or amount. Therefore, there has to be a liability that is uncertain in terms of the reason and/ or the amount. The local tax office was of the opinion that that these conditions were not present because, in particular, the employees had not performed additional services that the business had to pay for.

The Cologne tax court however took a different view. The business's liability to give additional days off from work arises already before the time off work commences and arises for economic reasons. The business had bindingly committed to give further days off from work, the employees contributed their work effort as a preliminary input and the respective counter-performance will, in contrast, only be provided by the company in the future. The fact that the commitment is linked to the past period of service and to the future company loyalty of the individual employees does not preclude this.

An appeal against the ruling by the Cologne tax court is however already pending before the Federal Fiscal Court (Bundesfinanzhof, BFH). In response to the appeal against the denial to grant leave to appeal by the fiscal administration the BFH allowed the appeal (case reference: IV R 22/22), so that there will be a supreme court decision shortly.

New conditions for the adjustment of an invoice where the VAT is incorrectly stated

The ECJ has stated its position on a request from Austria for a preliminary ruling. This ruling is also applicable to German VAT law and will also affect the adjustment of invoices by German companies.

In the relevant year of 2019, the Austrian claimant operated an indoor playground whereby it provided its services exclusively to private end users. The billing was via invoices for small amounts with the VAT stated separately and calculated on the basis of the standard rate. Having realised that the reduced VAT rate would have been applicable, the claimant adjusted its VAT return and asked the tax authorities to refund the difference. However, the latter assumed that the total amount that was stated was owed and rejected the request. Firstly, the claimant had not adjusted its invoices and, secondly, the adjustment that was sought would have resulted in the claimant being unjustly enriched since its customers would have had to bear the costs of the higher rate of VAT.

Up to now, in such cases, the German fiscal administration required an effective invoice adjustment in order to recover the VAT - irrespective of whether or not the invoice recipient was a business. The ECJ, in its ruling of 8.12.2022 (case: C-378/21), concluded that a company that has supplied a service and that had stated on the invoice an amount of VAT calculated on the basis of an incorrect rate is not liable for the part of the VAT invoiced incorrectly if there is no risk of loss of tax revenue.

Result: This requirement was fulfilled here since the relevant service was provided exclusively to end users who were not authorised to make input tax deductions. Therefore, there was no need for an adjustment to the invoice.

Not to be missed - the Little Mermaid

AND FINALLY...

"Any Government, like any family, can for a year spend a little more than it earns. But you and I know that a continuation of that habit means the poorhouse."

Franklin Delano Roosevelt, born on 30.1.1882 in Hyde Park, New York; from 4.3.1933 until his death on 12.4.1945 he served as the 32nd President of the United States.

Legal Notice

PKF Deutschland GmbH Wirtschaftsprüfungsgesellschaft

EUREF-Campus 10/11 | 10829 Berlin | Tel. +49 30 306 907-0 | www.pkf.de

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