PKF

Newsletter

Key Issue

Beware the tax trap in the case of share deals

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Dear Readers,

This June issue of our newsletter is dedicated almost entirely to tax and legal issues related to real property. In the Key Issue section, we provide information about how you can avoid the **risk of paying real estate transfer tax twice** when you acquire shares in a corporation **(share deal)** that holds real estate. Our second report is about how and under what conditions the **taxation of capital gains from a real property disposal** can be avoided - even if the real property has not been owned for ten years. Subsequently, we provide a compilation of those expenses that are incurred when a property is purchased and that can be immediately deducted as well as those that can only be deducted via depreciation; in doing so, we classify the **compensation payments made to tenants** so that they will **vacate their apartments**. In our fourth report, which was prompted by a fiscal court decision, we discuss the issue of taxation in Germany of **remuneration from abroad.**

In last month's Accounting and Finance section we took a look at investments in so-called **ETFs** and, in doing so, we turned our focus on private investors. In this month's issue, the focus is now on an assessment of the **tax implications** for investments that are held in a company's **business assets**; we provide a comparison between investments held as private assets, on the one hand, and direct investments in shares, on the other hand. In the report that then follows, we discuss current case law with respect to **bonuses** where there has been no obligation to pay out and **whether or not provisions can be created** in these cases.

In our Legal section, once more the topic is inheritance and, specifically, the circumstances under which the **disclaimer of an inheritance** while well-meant can actually result in difficulties.

We then embark on a new journey around the PKF locations in neighbouring countries through the illustrations that break up the reports from our experts. In this issue we start off in Poland.

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

Your Team at PKF

Warsaw – Modern skyline and the Palace of Culture and Science

Front cover photo: Gdansk – Historic town hall clock tower

Key Issue

Beware the tax trap in the case of share deals

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TAX

StB [German tax consultant] Holger Wandel

Beware the tax trap in the case of share deals

The fundamental changes to the Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz, GrEStG)* are now sufficiently well known. Their aim was to prevent the circumvention of regulations in order to achieve tax neutrality, in particular also, through so-called share deals. Subsequently, the procedural requirements relating to real estate transfer tax (RETT) in the case of share deals were modified within the framework of the 2022 Annual Tax Act *(Jahressteuergesetz, JStG).* The respective structuring arrangements will need to be carefully considered in order to avoid a tax pitfall.

1. Administrative opinion on signing and closing

Insofar as a corporation holds real estate, in the event of a sale of company shares (share deal) there will basically be two points of reference with respect to a corporation's real estate holdings that could trigger RETT:

» The date on which the transaction imposing a legal obligation is concluded (the so-called signing) normally triggers RETT under Section 1(3) or (3a) GrEStG.

» The performance part of a contract (so-called closing) normally triggers a taxable event under Section 1(2) or (2a/2b) GrEStG.

The legislation provides that Section 1(2) or (2a) GrEStG take precedence over Section 1(3) GrEStG. What this actually means is that, in such cases, RETT should generally only be determined for the closing event. However, the fiscal administration assumes that the provisions concerning a signing event and a closing event relate to parallel applicable events that generate a RETT liability insofar as – in practice, in the vast majority of cases – the signing and the closing do not coincide. Consequently, when this opinion is adopted in the case of share deals, RETT is generally incurred twice.

Now, this is not a new problem and, in practice, it has hitherto been resolved by the fiscal administration determining RETT solely for the signing event if the closing has not taken place within a year of the administration learning of the transaction. Although, this is merely an administrative instruction and not a legal provision.

2. New legal provisions

In the 2022 JStG, the lawmakers created a very formalistic solution that will now be applied in the above-mentioned problem area. The introduction of Section 16(4a) GrEStG provides for the legally mandated cancellation of an event that generates a RETT liability in the case of a signing circumstance if the transaction has been closed and, therefore, an event that generates a RETT liability under Section 1(2a) or (2b) has taken place. According to this, in the case of a share deal, the RETT should generally be incurred only once. If the RETT had previously already been determined for the signing event then this assessment would have to be cancelled.

However, a highly problematic practical implication is the further requirement, set out in Section 16(5) sentence 2 GrEStG, which was likewise introduced via the 2022 JStG. According to that, the RETT for the signing event would only be retroactively cancelled if the required notifications associated with the signing have been made in due time and in full. If, for example, a complete report of the event that generates a RETT liability is not received by the local tax office within two weeks after the signing then, under the new legislation, there would be a risk of double taxation in respect of RETT. Given that, in such a case, this would usually involve high-priced real estate in business assets there would be a latent risk of a high six-figure tax demand.

Recommendations

If the companies that are acquired hold real estate then it would be important to ensure that the notification deadlines of two weeks are complied with. Yet, this can pose a particular practical challenge because, in the case of a share deal, the acquirer would be obliged to submit a report even though, frequently, at that juncture the requisite information with the sufficient level of detail would not be available. In this respect, it is important to address the problems already during the purchase price negotiations in order to be able to comply with the deadlines.

RA/StB [German lawyer/tax consultant] Sascha Wegener

Sale of properties held as private assets – Recognise and avoid the tax pitfalls

Capital gains on personal property are not generally subject to income tax. Even the capital gain on a property that was used to generate income from 'leasing and letting' would only be subject to income tax if the time period between the purchase and sale is no longer than ten years. Furthermore, in the event of a sale of a commercial property that is leased out there would still be potential VAT consequences to be taken into account. In the following section, we provide an overview of the possible tax consequences that you should bear in mind if you are intending to sell a property.

1. 10-year holding period until you can sell a property tax-free

To calculate the requisite holding period, pursuant to Section 23(1) of the Income Tax Act *(Einkommensteuergesetz, EStG)*, it is solely the dates of the signing of the respective notarial purchase agreements for the acquisition and the sale of the property that are relevant, irrespective of the transfer of the physical possession of the property, the benefits and encumbrances (cf. rulings by the Federal Fiscal Court *[Bundesfinanzhof, BFH]* of 15.12.1993 and 8.4.2014; as well as the administrative opinion, cf. German Income Tax Guidelines, Guideline 23 (EStH, H23) bullet point related to holding period until you can sell a property tax-free *[Veräußerungsfrist]*). If there is a period of more than ten years between the respective notarial purchase agreements then the capital gain on privately held properties will be tax-free. Even if, in the meantime, a building has been constructed on a plot of land that was initially unbuilt then this would not constitute the commencement of a new 10-year period (cf. Section 23(1) sentence 1 no. 1 sentence 2 EStG). This is also the opinion of the fiscal administration that has issued the following example in this respect. "On 31.3.1993, 'A' pur-

Castle Square in Warsaw

chased an unbuilt plot of land. In 1998, he completed the construction of a single-family house, which he subsequently rented out. As of the 1.4.2003 he has been able to sell the developed real property without the gain being subject to tax under Section 23 EStG“ (Federal Ministry of Finance circular of 5.10.2000, Federal Tax Gazette (BStBl) I 2000 p. 1383, margin no. 9).

Please note: German law-makers have moreover adopted an exception with respect to the taxation of private property sales, namely, if the property is admittedly sold within the 10-year period, but has been used exclusively for own residential purposes, or at least during the year in which the property was sold as well as in the two preceding years (Section 23(1) sentence 1 no. 1 sentence 3 EStG). In addition, you should bear in mind that the BFH has already decided on several occasions (inter alia ruling of 3.9.2019, case reference: IX R 10/19; decision of 3.8.2022, case reference: IX B 16/22) that ‘interim letting’ shortly before the sale would not be harmful for the application of this exemption provision. According to case law, it would be sufficient if there had been a consecutive period of self-use of one year and two days; in this case, the period of use for own residential purposes would have had to have stretched over the entire year that preceded the sale of the property so that there would have been self-use of the property in the second year prior to the sale on the last day, at least, and on the first day in the year in which the sale took place.

2. VAT aspects

2.1 Tax liability option in the case of rentals

Normally, pursuant to Section 4 no. 12a of the VAT Act *(Umsatzsteuergesetz, UstG)*, the (long-term) renting out of property is exempt from VAT, so that input VAT may neither be deducted when the property is acquired nor during the production of a building. However, the situation is different where, in accordance with Section 9(1, 2) UStG, for example, commercial premises are rented out to other businesses and the VAT liability option has been selected. This gives the landlord the advantage of being able to deduct VAT on incoming supplies as input VAT. This will apply even if the property is held in private assets; this is because even if the asset management is not carried out as an independent activity, the renting out is regarded as a business activity within the meaning of the UStG. The same will also apply for the sale of a property, that under Section 4 no. 9a UStG, is admittedly generally tax-free, although here, too, under Section 9(1, 3) UStG it is possible to opt for VAT liability.

2.2 Transfer of a going concern

However, if you are intending to sell, you should first check to see if the transaction could be a non-taxable, so-called, transfer of a going concern (TOGC) pursuant to Section 1(1a) UStG. This could be the case if, for example, a single property is sold from among several rental

Krakow - Wawel Royal Castle

properties, the acquirer continues the lease agreement and, in doing so, a separately run going concern is transferred. The conditions for this would thus not be satisfied if the vendor of the real property had already terminated its rental prior to the sale, or if the property is sold to the previous sole tenant. Moreover, a TOGC should not be assumed if a property development company transfers a real property. This is because, in such a case, the acquirer would not continue running the property development business, but would instead run a (new) letting company.

Please note: The reason why this is particularly important is because, in the case of a TOGC, given that there is no eligibility for taxation it would not be possible to opt for a tax liability under Section 9 UStG. Moreover, no input tax adjustment pursuant to Section 15a UStG will be triggered either because for the purchaser the adjustment period, described below, continues ('footprint theory', Section 15a(10) UStG).

2.3 Adjustment of the input tax deduction

If the transfer fails to qualify as a TOGC then you should bear in mind that the relevant circumstances within the meaning of Section 15a UStG could change and this could result in a considerable input tax adjustment. Here, the law also provides for an adjustment period of ten years (Section 15a(1) sentence 2 UStG). However, in this case, the adjustment period would only commence on the date when the asset is used for the first time (Section 15a(1) sentence 1 UStG). In this context, the date on which the input tax was actually deducted is also irrelevant.

Recommendations

The start of the 10-year period under income tax and under VAT can differ considerably from each other on account of the different reference points. That is why, if you are intending to sell, you should make a detailed assessment of the income tax and VAT consequences. In cases of doubt here, we would recommend getting tax advice and, where necessary, including the respective tax clauses in the notarial purchase agreement in the event that the legal opinion of the fiscal administration differs from that of the parties to the agreement.

StBin [German tax consultant] Sabine Rössler

Compensation payments made to tenants as immediately deductible expenses

According to a ruling recently issued by the Federal Fiscal Court *(Bundesfinanzhof, BFH),* payments made to tenants to compensate them for moving out early from a let residential property can constitute a deductible cost related to letting. In the following section we have first classified the requirements and then set them out in further detail.

1. The BFH has accepted immediate deductibility

According to the BFH ruling of 20.9.2022 (case reference: IX R 29/21), financial settlements are fully deductible in the year in which they were paid if the aim is to refurbish the property once the tenant has moved out. Admittedly, obtaining a vacant property by paying a financial settlement will enable or facilitate the refurbishment works. However, in the opinion of the BFH, the financial settlements do not constitute acquisition-related production costs for the property under Section 6(1) no. 1a of the Income Tax Act *(Einkommenssteuergesetz, EStG)* that would have to be depreciated on a pro rata basis.

2. Subsequent production costs

Depreciation for a let residential property is included in the deductible costs for income from letting and leasing. The costs incurred for modernisation and maintenance (refurbishment) within a period of three years after the acquisition of the property would increase the assessment base for depreciation if a defined limit is exceeded. Such refurbishment expenses cannot be deducted immediately as costs related to letting and leasing but, instead, they constitute subsequent production costs and have to be depreciated over the useful life of the property.

These expenses include any and all building measures that are carried out at the time of the acquisition and through which defects and damage that are affecting the property are eliminated or through which the property is modernised. By contrast, the costs related to annually incurred maintenance expenditure do not constitute any production costs and they are thus immediately deductible.

3. Building measures - Narrow definition

According to the BFH, only building measures in the narrow sense can result in the recognition of subsequent production costs. This includes costs that would generally be deemed to be maintenance expenses such as, for example, the repair or renovation of existing sanitary, electrical and heating systems, floor coverings, windows and roof coverings. If certain expenses are merely materially related to the refurbishment and represent measures carried out at the same time then this alone would not be sufficient. In the above-mentioned ruling, the BFH quoted the preamble to the provision on subsequent production costs according to which

- "Repair and Modernisation Expenditure" *[Reparatur- und Modernisierungsaufwendungen]* (Bundestag printed matter 15/1562 p. 24),
- "Costs for Maintenance and Modernisation" *[Aufwendungen für die Instandsetzung und Modernisierung]* or
- "Costs for Maintenance Works" *[Aufwendungen für die Instandsetzung und Modernisierung]* (Bundestag printed matter 15/1562 p. 32)

are supposed to be regulated. According to the BFH, costs that do not constitute a portion of those for maintenance and modernisation measures have to, in any case, be subjected to a separate tax law evaluation.

4. Financial settlements for tenants do not constitute maintenance/ modernisation measures.

The BFH does not consider financial settlements for tenants to be maintenance or modernisation measures within the meaning of Section 6b(1) no. 1a EStG. They are not included under building measures. Measures for cancelling an existing tenancy do not form part of the maintenance and modernisation of the substance of a building. Admittedly, the costs of demolishing an existing building on a property that was acquired for the purpose of redevelopment do indeed constitute the production costs of a new construction within the meaning of Section 6(1) no. 1 EStG if the new building is constructed on the site of the building that was demolished and, therefore, the demolition of the old building was a requirement for the construction of the new asset. Nevertheless, here, the use of the term production costs should be understood in a wider context. It is sufficient if the expenditure is made with the aim of production. By contrast, the presumption of subsequent produc-

Wroclaw – Odra (Oder) river bank with Gothic cathedral

tion costs implies that the expenses are incurred "for maintenance and modernisation measures". Furthermore, the BFH also pointed out that while the rule on acquisition-related production costs was based on the assumption that a lower purchase price had been calculated in view of the necessary maintenance expenditure so that, from an economic perspective, the cost of rectifying this forms part of the purchase price. Although this applies only precisely to building measures and not however to financial settlements for tenants.

Outcome

According to the BFH, financial settlements for tenants or compensation payments would not be reflected in a permanent increase in the value of a building so that the buyer of a property would normally have no reason to remunerate the vendor via a higher purchase price.

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

Taxation in Germany of remuneration from abroad

If an employee residing in Germany works abroad then the question that arises is if and to what extent the income can also be taxed in Germany. Even if, under the double taxation agreement (DTA), the foreign state has the right to tax, nevertheless, there can still be circumstances where the income received abroad will be taxed in Germany.

1. Avoiding double taxation

If an employee normally works abroad then the income has to be taxed abroad. In addition, because the employee's residency is in Germany it, too, has a right to tax. To prevent double taxation, in Germany, the income is exempted from tax under the so-called exemption method. Generally, when this method is used it is irrelevant whether or not the foreign country where the employee works exercises its right to tax. Although, the condition for applying the exemption method in Germany is that the income also actually has to be taxed abroad. Taxation in Germany would also be possible if only parts of the income were not taxed abroad.

2. Differing legal situations in Germany and the Netherlands

Recently, an employee who lives in Germany and had received remuneration from his Dutch employer brought a legal action before the Düsseldorf tax court. In the Netherlands, employees who take up a job there and, for this reason, move house or travel daily from another country to the Netherlands get a refund. Employees are thus supposed to be compensated for the additional costs that arise for them as a result of their stay in the Netherlands. As an alternative to the option of having the additional costs refunded, employers are also able to pay out 30% of the remuneration free of tax. With this alternative it is not necessary to show the costs that have actually arisen. The only requirement is that the employee has to have special expertise in a specific sector.

In Germany, the competent local tax office did not fully exempt the claimant's foreign income, but instead made the portion of the income (30%) that was not taxed in the Netherlands subject to German tax. The DTA with the Netherlands provides for the income in the Netherlands to also "actually be taxed".

3. Only the portion that is actually taxed abroad will be exempted

However, according to Germany's legal position, if the income abroad is only partially taxed then this would not be sufficient in order to fully exempt the income from tax in Germany. On that point, the Düsseldorf tax court decided on 25.10.2022 (case reference: 13 K 2867/20 E) that the portions of the remuneration that would not be taxed in Germany would be solely the ones that had been taxed abroad. Accordingly, in this case the 30% that would not be taxed in the Netherlands would have to be subjected to German tax. Admittedly, in Germany portions of income are also generally not taxed (the so-called standard deduction amount). However, the 30% rule is more comparable with a basic tax exemption than with a generalisation provision.

Outcome

In order to avoid a significant overcompensation of the actual expenses, in Germany, only the portion that has actually been taxed abroad was accordingly exempted.

ACCOUNTING & FINANCE

Adrian Tammen

Building assets with ETFs in an asset management GmbH [limited liability company] as opposed to private assets (Part 2)

The effects of compound interest while building assets are mainly impacted by the tax implications. In the May issue of our newsletter we had a look at private investors. Here, in part 2, the focus is now on the tax implications for investments in the business assets of a GmbH as opposed to private assets.

1. Assessment of the advantages of an asset management GmbH

In part 1 of this report we highlighted that, following the sharp rise in interest rates, currently, there is usually tax parity between distributing and accumulating sister ETFs. This will apply irrespective of whether the securities are held in private or business assets.

Attention also needs to be paid to the fact that the pre-determined tax basis means that, particularly in the case of accumulating securities, exceeding the flat-rate savers' allowance within the meaning of Section 20(9) of the Income Tax Act *(Einkommenssteuergesetz, EStG)* could trigger tax payments in private assets even though no cash inflow has taken place. Consequently, an effective tax rate of 26.375 % would be applied.

In such a case, for wealthy private individuals, using a corporation (normally a GmbH) could constitute an advantage in order, for example, not to have to manage ETFs in their private assets. The background is generally the positive effects generated by compound interest as a result of the temporary tax deferral in the business assets of a GmbH when compared with private assets.

The relevant factors for assessing the advantages of an asset management GmbH are, besides the amount, composition and source of the assets, also the investment strategy, investment horizon and the plans for how to use the assets at the end of the investment horizon. In this context, in the following section, we show, by way of example, the relevant tax implications resulting from income from equity ETFs. We likewise present the tax implications of direct investments in individual shares to highlight the difference.

2. Tax implications in the case of income from equity ETFs and ...

For the taxation of income from equity ETFs it is necessary to differentiate between the various types of income (realised capital gains, distributions and pre-determined tax bases), which are bracketed together as investment income within the meaning of Section 16 of the Investment Tax Act *(Investmentsteuergesetz, InvStG).* In the case of an asset management GmbH, under Section 20(1) sentence 3 InvStG, just 20% of investment income from equity ETFs would be included in taxable income for corporation tax purposes. By contrast, under Section 20(5) InvStG, 60% of the income would be included in the assessment base for trade tax purposes.

Note on private assets: The above-described partial exemption under Section 20(1) sentence 1 InvStG for income from equity ETFs in private assets is 30%.

... in the case of income from shares

On account of the attractive income tax rules for corporations with respect to investments in (individual) shares we have provided a comparison of the tax implications with direct investments. For the taxation of income from shares a distinction likewise has to be made between the different types of income (realised capital gains, dividends).

In the case of an asset management GmbH, under Section 8b(2) in conjunction with (3) of the Corporation Tax Act *(Körperschaftsteuergesetz, KStG)*, irrespective of the size of the shareholding, realised capital gains will effectively be reduced by 95% in the tax assessment base (off-balance sheet) while, in the case of dividends, the size of the shareholding will always have to be taken into account. For corporation tax purposes, under Section 8b(1) in conjunction with Section 8b(4) and (5) KStG, dividends would only be taxed similarly to capital gains if the shareholding in the distributing incorporated company was at least 10% at the start of the calendar year. For trade tax purposes, under Section 9, no. 2a of the German Trade Tax Act, the share-

holding even has to be 15% in order to reduce the dividend by 95% in the assessment base.

Note on private assets: Under Section 20(9) EStG, the amount by which the realised capital gains and dividends exceeds the flat-rate savers' allowance has to be fully included in the tax assessment base.

3. Differences in the tax implications

If the solidarity surcharge is included and it is assumed that trade tax will be charged at a rate of 15% then this would give rise to the following tax implications (when limited to the GmbH level and capital gains):

	Asset management GmbH	Private assets
Equity ETF	12.17 %	18.46 %
Shares	1.54 %	26.38 %

If you create an asset management GmbH for your investments in equity ETFs, it would be possible to reduce the effective rate of tax from 18.46% to 12.17% (if the assessment is restricted to the company level). This effect is based on the significantly higher partial exemptions for the business assets of a GmbH. Insofar as this difference overcompensates for the structural costs of the GmbH, the loss of the flat-rate savers' allowance at the company level as well as the high tax charge for a distribution in private assets then using such a structure will serve to maximise overall final net assets. This advantage would be even more likely, the higher the amount of assets and the higher the trading frequency.

In private assets, an equity ETF when compared with an identical basket of (individual) shares would generally be tax privileged (18.46% instead of 26.38%). By contrast, when an asset management GmbH is used for direct investments in shares, the tax charge of 1.54% would be very much more advantageous than for ETFs (12.17% > 1.54%). It should however be noted that this difference will, in turn, be reduced the higher the dividend is as a share of the overall yield.

Recommendation

For a comprehensive assessment of an asset management GmbH a case-by-case review would have to be carried out (e.g. by drawing up a complete financial plan) whereby the distributions by the asset management GmbH would have to be included at the private level.

The modern sport and events centre in Katowice


Gdansk – Motlawa river bank in the old town

Employee bonuses where there is no legal entitlement – A provision is nevertheless possible

A provision for liabilities of uncertain timing or amount presupposes, among other things, that payment is more likely than not. According to a ruling by the Münster tax court, a sufficient degree of probability that the liability will arise can also ensue from a standard practice that has been maintained for years, namely, paying out employee bonuses where there is no legal entitlement. Leave to appeal was not granted.

1. Agreement on bonus payments

In the case ruled on by the Münster tax court, of 16.11.2022 (case reference: 13 K 3467/19 F), a GmbH [a limited liability company] paid a bonus to its employees, although there were no written agreements in place about this. New employees, at the time of recruitment, were given, among other things, the following information: "For years where there is a good business performance and a favourable outlook the GmbH pays a bonus to its employees in the spring of the subsequent calendar year. This bonus is a voluntary payment to which there is no legal entitlement." In actual fact, the GmbH had paid a bonus to its employees in previous years, in the relevant year of 2014 as well as in the subsequent years. In the relevant year, an amount of around €300,000 was added to the provision. However, the local tax office did not recognise the provision. The local tax office justified this by invoking the fact that the employees had no legal entitlement to a bonus payment. Furthermore, the voluntary bonus payments were based not only on the operating results of the preceding financial year, but also on the future earnings performance.

2. Recognition of the provisions was permitted

The GmbH subsequently argued that the payment of employee bonuses was also communicated externally - the binding rules for event-related gifts as well as for bonuses were explained on the company website. The reservation of discretion merely meant that in a loss-making year no bonus would be paid. The Münster tax court recognised the provision. This may be created not only when a liability definitely exists on the balance sheet date and solely the amount is indeterminable, but also when there is a sufficient degree of probability that the liability will, in principle, arise in the future, although its amount can also be indeterminable. In the reasons for its judgement, the tax court analysed, in particular, the criterion of the "probability that the liability will, in principle, arise in the future", although it would already be sufficient that the liability is more likely than not ("51 %").

Outcome: In the case in question, the result was that a sufficient degree of probability did exist that the liability in

respect of the payment of employee bonuses would arise, in particular, based on the standard practice of A-GmbH, over many years, of paying employee bonuses to the staff without being legally obliged to do so. Indicators that could be externally identified that, in the relevant year, A-GmbH planned to back away from this standard practice were not evident. Furthermore, the economic cause for the liability that would arise in the future lay in the period prior to the balance sheet date because the legal and economic reference points for the liability lay in the past.

LEGAL

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

The decision to disclaim an inheritance should not be taken lightly

Disclaiming an inheritance is a move that could be considered not merely where the aim is to avoid personal liability for the deceased person's debts. In some circumstances, disclaiming an inheritance can also make it possible for appropriate adjustments to be made in the line of inheritance that has arisen (so-called 'directive disclaimer of an inheritance", in German: *lenkende Erbausschlagung*). If, however, you make a mistake with respect to the new line of inheritance, the consequences could be very annoying and irreversible.

1. Issue – Directive disclaimer of an inheritance

In a recent court case, the children of a father who had passed away had also been thinking about a 'directive disclaimer of the inheritance'. They disclaimed their inheritance under the assumption that, by doing so, their widowed mother would be made the sole heir and the sole owner of the home in which she had been living. This is because, in the event that the inheritance is disclaimed, the act of inheriting is deemed not to have taken place from the outset and the order within the line of inheritance will be as if the person disclaiming the inheritance had never lived.

However, the parties involved had overlooked that – hitherto unknown to them – the father had half-siblings who then, in accordance with the legal order of inheritance, became the heirs instead of the children and, thus, not solely their mother as they had ultimately planned. With reference to this mistake, the deceased person's son appealed against his renunciation declaration and requested that a certificate of inheritance be issued stating that he and his mother were each heirs to ½ the estate.

2. Decision – No appeal against the renunciation declaration

However, the probate court *(Nachlassgericht)* refused this request because this had been merely an insignificant error in motive that did not justify any appeal against the renunciation declaration. The Federal Court of Justice *(Bundesgerichtshof, BGH),* in its ruling of 22.3.2023 (case reference: IV ZB 12/22) has now confirmed this view and, as a result, clarified a much-disputed point of law. The error as to the specific person who would then be included in the line of inheritance once the deceased person's children had been removed is an error relating to an indirect side effect of the renunciation declaration and would not justify an appeal. Therefore, in this case, it also did not matter whether or not the son had been aware of the existence of the half-siblings.

3. Recommendation

We would therefore strongly recommend that heirs who are considering disclaiming their inheritance should get an overview not only of the inventory of the deceased's estate, including any over-indebtedness, but also of the family connections and the substitutes in the line of inheritance.

You will not have a lot of time for this because an inheritance can only be disclaimed within a period of six weeks after becoming aware of it. You will need to make a declaration to a German probate court either for the court record, or in an officially or notarially authenticated form.

Please note: Sometimes, disclaiming an inheritance can also be an appropriate course of action from an inheritance tax perspective. This could possibly involve the popular Berlin-style will *(Berliner Testament)* where, to begin with, spouses mutually appoint each other as sole heirs. Here, tax advantages could be generated if the surviving spouse does indeed renounce the inheritance and the assets are then transferred directly to the children. Otherwise, the tax-free allowance that would be available after the first death would be wasted. Since the disclaimer can also be made in return for a financial settlement, structuring potential would definitely be available in such a case.

IN BRIEF

Usufruct of a benefit as abusive structuring?

When usufruct agreements are made between, in particular, parents and their (under-age) children, disputes over the recognition for tax purposes frequently arise with the local tax office if the latter assumes that the structuring is abusive. Recently, the Berlin-Brandenburg tax court rejected the structuring for the creation of a usufruct. The parents lodged an appeal against this decision so that the Federal Fiscal Court will now have to rule on the case.

Generally, the establishment of a usufruct of a benefit over a rental property in favour of a close relative will be recognised if the usufruct is agreed as if between unrelated third parties and actually implemented. Moreover, the usufructuary has to hold the legal status of a landlord vis-à-vis the tenants. If these conditions are satisfied then the income from letting will no longer be attributable to the owner but, instead, to the usufructuary.

The Berlin-Brandenburg tax court, in its decision of 21.3.2022 (case reference: 6 K 4112/20), had to rule on a case where the parents had created a usufruct for their dependent children, for a limited period, over a real property that was leased out for the long term, up to the end of the usufruct, to a GmbH [limited liability company] controlled by the parents. In the reasons for its ruling, the court considered supreme court case law in detail and ultimately rejected the present arrangement.

The non-recognition of the usufruct was a consequence of the fact that a GmbH controlled by the parents could not be regarded as an unrelated third-party entity. The decision-making process was thus not independent of the parents. Furthermore, the time-limited transfer of a lease agreement between the parents and the GmbH, which is non-cancellable for an identical period of time, to the under-age children seems to be uneconomic.

Please note: In the appeal (case reference: IX R 8/22), the Federal Fiscal Court will now have to conclusively rule on whether or not this usufruct of a benefit constitutes abusive structuring with the aim of using the children's tax-free allowances and lower tax progression.

Pension commitments – No provision where there are harmful reservations

The requirements for creating a provision within the meaning of Section 6a of the Income Tax Act *(Einkommensteuergesetz, EStG)* would generally not be met if the pension commitment included the reservation of the right to make changes. Recently, the Federal Fiscal Court *(Bundesfinanzhof, BFH)* had to rule on a case where an employer was able to change the 'transformation table' and the discount rate at his own discretion.

In order to be allowed to create a pension provision pursuant to Section 6a EStG a number of requirements have to be met. This includes, for example, that the pension commitment has to be made in writing and, moreover, clear information has to be provided about the type, form, conditions for and amount of the future payments that can be expected. Furthermore, the commitment may not include any reservation that could lead to the entitlement to the pension or the pension payment being reduced or withdrawn.

The BFH, in its ruling of 6.12.2022 (case reference: IV R 21/19), decided that, for tax purposes, the creation of a pension provision may only be allowed if the reservation expressly complies with the narrowly defined circumstance, which has been recognised by the German labour courts, that would permit the entitlement to the pension or the pension payment to be reduced or withdrawn solely in exceptional cases.

By contrast, unrestricted reservations of the right of cancellation where the validity or scope under employment law is doubtful or unclear would be harmful.

Outcome: In the case in question, unrestricted reservations of the right of cancellation were likewise used since the reservation of the right to make changes to the pension commitment meant that amendments could be made at the discretion of the employer. Accordingly, in the case in question, the creation of a provision was not legitimate.

Attempted coercion – No right to ‘safely store’ an improperly parked e-scooter

Parisians recently voted to clear e-scooters from their city’s streets in the future. In Germany, by contrast, such a decision will probably not be made for the time being, especially because, under German criminal law, the removal of undesirable or irritating objects from public grounds on someone’s own initiative would not be tolerated. Against this background, the Local Court (Amtsgericht) in Düsseldorf had to adjudicate on the case of an improperly parked e-scooter.

In the case ruled on by the Düsseldorf judges on 12.1.2023 (case reference: 126 Cs 248/22) the claimant’s garage had been blocked by an e-scooter. He had used a handcart to remove the scooter and put it in his garage; he then contacted the company that rented out the e-scooter and demanded €35 for its return. The company did not however pay the amount that he had demanded, but instead filed a charge of attempted coercion. In addition, he was issued with a warning that he would be fined €3,000 in the event of a repeat offence. The person concerned objected to this way of proceeding. He stated that there had been no coercion, in fact, by charging €35 he had wanted to be reimbursed for the time and effort required to remove the scooter and for writing the letter.

However, the Amtsgericht in Düsseldorf decided that moving the scooter out of the way would have been sufficient. Keeping something and demanding a sum of money for its return constituted attempted coercion. Using threats to compel another person to behave in a specific way would make you guilty of coercion. Attempted coercion occurs when the victim resists involuntarily bending to somebody else’s will and, consequently, does not allow themselves to be compelled to carry out the actions demanded by the perpetrator. The defendant subsequently withdrew his objection and, in addition, has to pay €200 to a charitable institution.

Warsaw – View into Piwna street in the old town

AND FINALLY...

"The hard part of running a business is that there are a hundred things that you could be doing, and only five of those actually matter, and only one of them matters more than all of the rest of them combined. So figuring out there is a critical path thing to focus on and ignoring everything else is really important."

Samuel H. Altman, born on 22.4.1985 in Chicago, US American entrepreneur, investor and programmer. Founder and CEO of OpenAI LP, which has developed ChatGPT.

Please note: Elon Musk, a co-founder of OpenAI, has described artificial intelligence as the biggest existential threat to humanity. To counter this risk in the development of artificial intelligence, OpenAI was set up as an open source non-profit organisation. The independence of the organisation vis-à-vis the investors and their interests would thus be ensured; the aim was to provide autonomy for the research so that it would have a positive effect on society in the long term.

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