PKF

Newsletter

Key Issue

Protection against the loss of tax revenues caused by cross-border arrangements

02|24

Dear Readers,

Our Key Issue report in this February edition of our newsletter deals with the **protection against the loss of tax revenues caused by cross-border arrangements**. To this end, German lawmakers have enshrined Section 4k in the German Income Tax Act for situations where income is not taxed or where it is solely the expenses that remain in Germany. Since this provision is formulated rather awkwardly, we took the publication of a Federal Ministry of Finance draft circular as an opportunity to systematically and comprehensibly interpret the **contents of Section 4k of the German Income Tax Act.**

This is followed by a report on **electricity tax relief**; Section 9b of the Electricity Taxation Act has been significantly broadened. As a consequence, very many businesses could receive electricity tax relief in 2024 - in some cases for the first time. For our third contribution an appropriate title could be: **Real estate tax** without end. New legislation with heterogeneous rules for the **subsequent determination of assessed value and for updating the value**, once again, skirts the edge of constitutionality and yet citizens are still being challenged. Subsequently, at the end of the Tax section, we also provide information about a Federal Fiscal Court ruling that is encouraging for members of **partnerships that are identical in terms of participation** who are planning to transfer assets.

In the Accounting and Finance section we discuss the impact that **inflation and higher rates of interest** can have on the level of company values and, thus, also on the measurement of **acquired goodwill**. Next up, we have a report where we present important **new regulations relating to the taxation of employee shares** that were introduced via the so-called German Future Financing Act as of 1.1.2024; these regulations will notably affect young companies, particularly start-ups, that make respective offers to their employees.

We then continue our journey around the international PKF locations through the illustrations that break up the reports from our experts; this time we stop off in London and the South of England.

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

Your Team at PKF

London design icons - The red double-decker buses ...

Front cover: ... as well as the red telephone boxes have survived.

Key Issue

Protection against the loss of tax revenues caused by cross-border arrangements

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

Protection against the loss of tax revenues caused by cross-border arrangements

Federal Ministry of Finance on the application of Section 4k of the German Income Tax Act

The different tax treatment of a situation in two disparate states can lead to the creation of structures that induce undertaxation. In 2021 already, German lawmakers established additional regulations to prevent such taxation incongruities or hybrid mismatches. The key elements of these rules can be found in Section 4k of the Income Tax Act *(Einkommenssteuergesetz, EStG)*. In the summer of 2023 already, the Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* issued draft administrative guidance in this regard. In the following section, we present selected elements of the BMF draft.

1. General scope of application and situations

Section 4k EStG applies objectively to cross-border situations

- in the case of structured arrangements,
- with related parties,
- with permanent establishments, or
- involving concerted practice.

From a timing perspective, the regulation applies to expenses that arose after 31.12.2019. Insofar as the expenses are based on a continuing obligation (rental agreement, etc.) that was previously concluded, Section 4k EStG would moreover only apply

- insofar as the expenses could have been avoided from the aforementioned date without material disadvantages, or
- if the continuing obligation was substantially amended after the 31.12.2019.

Section 4k EStG affects three categories of mismatches:

(1) Deduction/non-inclusion mismatch – A tax deduction for an expense in one country without a corresponding amount of income being taxed in the other country.

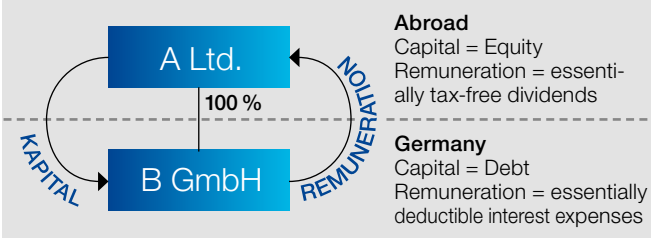
(2) Double-deduction mismatch – Tax deduction of the same expenses in several countries that is contrary to the system.

(3) Imported mismatch – Deductible domestic (German) expenses exist and the corresponding foreign income is offset by expenditure that, under Section 4k EStG, could not be deducted if the situation were to arise in Germany.

2. Protection against deduction/non-inclusion mismatches

2.1 No deduction of an expense in the case of a differing classification/attribution of the capital assets

If the income that corresponds to domestic (German) expenses is not taxed abroad, or only at a low rate, because of the differing classification or attribution of the capital assets then the law would deny the deduction of the aforementioned expenses. This situation may arise, for example, in a constellation with profit participation rights, convertible bonds, or other hybrid financial instruments as outlined in the following figure:

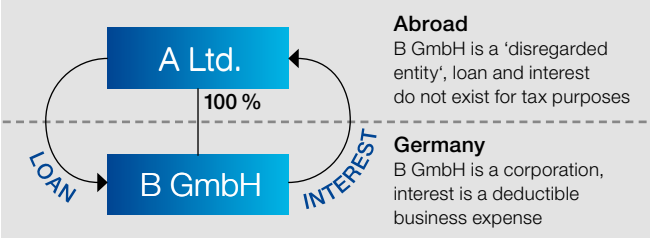


The BMF draft stresses that the taxation incongruity has to be the reason for applying the anti-hybrid rules. The assumption of undertaxation can be eliminated if, for example, interest income abroad is subject to CFC rules. By contrast, undertaxation should be presumed if the taxation is lower than if the foreign classification/attribution had been carried out in conformity with the German concept.

2.2 No deduction of an expense in the case of differing treatment of the taxpayer

If non-taxation occurs as a consequence of the taxpayer being treated differently abroad from the way they would be treated in Germany then Germany would thus deny the deduction of the expense (this would also apply in

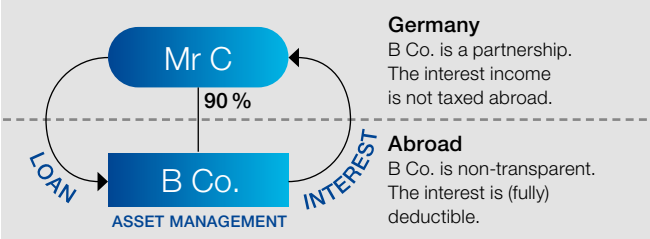
comparable permanent establishment situations). For instance, such a situation could arise as follows:



In this regard, the BMF draft clarifies that the rules may generally affect any sort of expense so that the scope of their application extends far beyond the simple example that has been outlined.

2.3 Taxation of income in Germany in the case of differing treatment of the company abroad

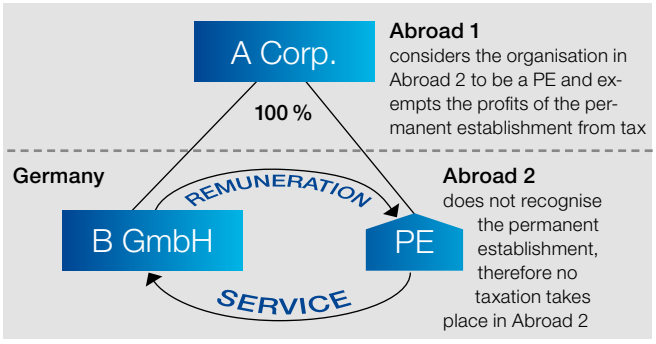
Insofar as an expense is tax deductible abroad and the corresponding income is however not taxed by the shareholder in Germany on account of the differing treatment of a company then, in a break with the basic German tax perspective, the aforementioned income should nevertheless be taxed. Such a case can occur, for example, if a German shareholder Mr C enters into contractual relationships with his foreign company as outlined below:



Here, in view of Section 4k EStG, the German shareholder's interest income would be taxed in Germany.

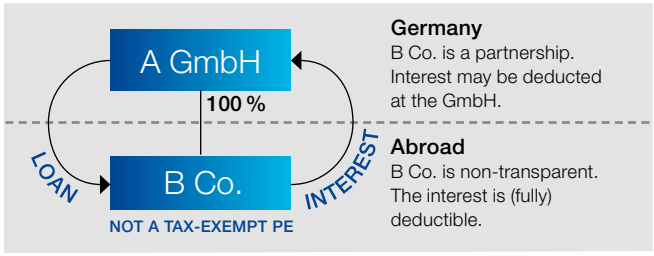
2.4 No deduction of an expense in the case of the non-taxation of income abroad

Finally, in addition to the previous situations, Germany would deny the deduction of an expense if the corresponding income is not subject to tax because of a differing classification/attribution abroad. This can occur, for example, if two states assume that there is a permanent establishment in a third state and regard this as the entity to which profits are attributed, while the latter state does not tax the relevant amounts because, from its point of view, no permanent establishment exists.



3. Protection against double deduction mismatches

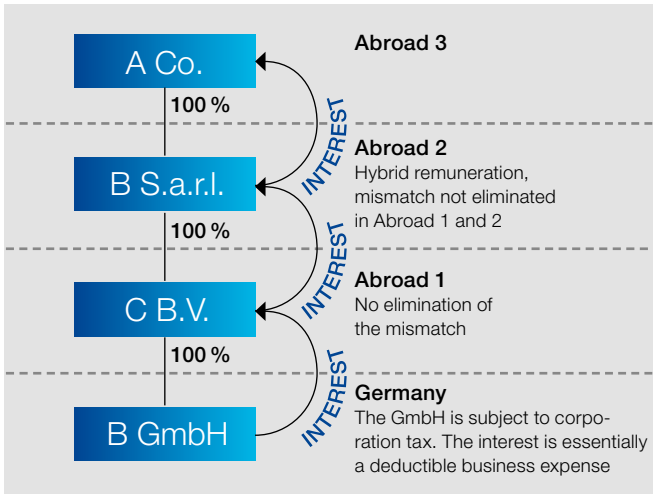
Insofar as expenses lower the tax assessment base both abroad and in Germany then the deduction of these expenses would be denied in Germany as, for example in this case:



Please note: While the guidelines in the BMF draft on the cases mentioned above under section 2 go into considerable detail and are illustrated with examples, the comments on double deduction mismatches are however merely brief and abstract.

4. Protection against imported mismatches

These mismatches relate to multi-level structures such as, for example, those shown in the following diagram. In the case that is depicted, Germany now denies the deduction of the interest expense under Section 4k EStG. In its draft, the BMF included detailed explanations in this regard and supported them with examples.



Please note: In doing so, the BMF has, among others things, established an important rule according to which

the order of the analyses should start with the German taxpayer's direct creditor and then continue on to the next highest level.

5. Further details

The legal provision in Section 4k EStG includes various exceptions where no adjustments are made to income. The BMF draft also addresses these escape rules, for example, the elimination of the mismatch in a future taxable period or proof of dual inclusion income.

Please note

Large parts of the BMF draft show a clear attempt by the executive to limit the scope of application of the anti-hybrid rules to a manageable level. The fact that, after several months, the BMF has not yet finalised its administrative guidance would however suggest that, behind the scenes, there is still a considerable need for coordination. Therefore, further developments remain to be seen.

Prof. Dr. Michael Rutemöller

Changes related to electricity tax relief from 2024

Through the 2024 German Budget Financing Act, which came into force on 1.1.2024, lawmakers approved changes related to the electricity tax and significantly broadened the scope of application of electricity tax relief in accordance with Section 9b of the Electricity Taxation Act *(Stromsteuergesetz, StromStG)*. As a consequence, a great number of businesses could receive electricity tax relief in 2024 – in some cases for the first time. The requirements as well as the application process for this electricity tax relief are discussed in more detail in the following section.

1. Businesses entitled to relief

Section 9b StromStG basically provides for relief from electricity tax for companies that draw electricity from the grid for business purposes. Those entitled to relief are not only agricultural and forestry businesses but notably also companies in the producing sector. The benefiting group of businesses likewise includes, apart from the manufacturing industry (primarily production enterprises, processing enterprises or building and construction service companies), for example, energy and water utility companies as well as businesses in the construction sector. Further details on this have been laid down in the Classification of Economic Activities, issue 2003 (WZ 2003) published by the Federal Statistics Office and there mainly in sections C to F.

Please note: By contrast, the wholesale and retail sector as well as the hospitality industry have been notably excluded here from the possibility of obtaining tax relief.

2. Amount of relief and minimum power consumption

In the wake of the new legal provision, the previous rate of relief under Section 9b StromStG has been quadrupled from €5.13/MWh previously to €20.00/MWh. The remaining electricity tax in accordance with Section 9b StromStG will thus fall to the level of the EU minimum tax rate of €0.50/MWh.

The tax relief will continue to be granted only insofar as it exceeds €250. This means that the minimum annual level of power consumption that businesses will need in order to claim the relief under Section 9b StromStG will come down from about 49 MWh (€250 / €5.13/MWh) currently to just 12.5 MWh (€250 / €20/MWh) in the future. As a consequence, considerably more businesses than up to now will be able to benefit from the tax relief.

Please note: The minimum level of power consumption shall be determined on the basis of the in-house use of each individual business; therefore, there will be no assessments made for multi-corporate enterprises or groups of companies.

3. Filing the application

Electricity tax relief will only be granted when an application is filed with the competent principal customs office. There is no charge for filing an application. Businesses whose amount of relief after deducting a €250 excess does not exceed an (expected) annual amount of €1,000 will only be able to file an application once in a calendar year. Put simply, this will apply to all businesses with a quantity of electricity of between 12.5 MWh and 50 MWh per year that is eligible for relief. For the 2024 calendar year, the application has to be filed by the 31.12.2025 at the very latest.

The relevant form for the application is number 1453 and

this can be downloaded and filled in online on the German Customs website at www.zoll.de. In addition, form 1139 (State aid self-declaration) and form 1402 (Description of the economic activities) have to be submitted with the application in any case.

In 2024 and 2025, businesses that have a quantity of electricity, which is eligible for relief, of more than 50 MWh will however be able to claim relief under Section 9b StromStG also throughout the year (depending on the preconditions, half-yearly, quarterly or monthly). This means that already in the course of 2024 this would result in a reduction in the regular electricity costs and, thus, greater liquidity in the business.

Recommendation: Therefore, the businesses concerned should review the economic viability of electricity tax relief throughout the year on the basis of calculations.

Form 1453 adjusted for the option of tax relief throughout the year should be available for downloading on the German Customs website as of February 2024.

Please note

The broader scope of application under Section 9b StromStG will initially only be valid for 2024 and 2025.

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

Real estate tax – Subsequent determination of assessed value and updating the value

Real estate owners had until 31.1.2023 to submit a real estate tax return as at the date of the main assessment of 1.2.2022. The reassessed real estate tax will have to be paid from 1.1.2025. In order for the assessed values to be adjusted on an ongoing basis, a main assessment is generally planned for every seven years. However, in the event that changes are made with respect to the real estate, it is possible that a subsequent determination of assessed value or an update of value could be mandatory already earlier.

Westminster Bridge with Big Ben and Parliament

1. Range of models and constitutionality

Ever since the announcement of the real estate tax reform, which was implemented in many German federal states using different models, doubts have been expressed about the constitutionality of the calculation models. In the meantime, these doubts have also been brought in complaints before various tax courts, thus, for example, before the Baden-Wuerttemberg tax court with respect to the so-called land value model, under the case reference: 8 K 2368/22 and 8 K 2491/22, or in relation to the federal model before the Rhineland-Palatinate tax court, under the case reference: 4 V 1295/23 and 4 V 1429/23.

Since, at this juncture, principal proceedings are not yet known to be pending before a supreme federal court and, notably, not before the Federal Constitutional Court, it is therefore entirely possible that, as of 2025, the 'new' real estate tax will be calculated on the basis of the real estate tax returns that have been submitted.

Despite the persisting uncertainty concerning constitutionality, a real estate tax return has to be submitted for changes that have occurred, under the conditions specified below in sections 2 and 3, by 31.1 of the subsequent year without being requested to do so by the local tax office. In Bavaria, Hamburg and Lower Saxony the relevant cut-off date for submissions is 31.3.

2. Subsequent determination of assessed value

Insofar as an economic unit is newly developed, or an economic unit that already existed is taxed for the first time, a subsequent determination of assessed value would have to be submitted, for example, in the following cases:

- completion of construction projects and thereby a change from undeveloped real esate to developed real estate,
- the dividing up of a plot or the discontinuation of a tax exemption.

3. Updating the value

If, since the date of the last assessment, the value of the real estate or the agricultural and forestry enterprise has changed by more than €15,000 (rule in the federal model and in Baden-Wuerttemberg) then a real estate tax return with an updated value would have to be submitted. This could be the case if

- the area of a plot of land is extended or reduced, or
- construction works have been completed.

4. Conclusion

Whether the real estate tax value is reassessed within the scope of a subsequent determination of assessed value, an updating of the value or a combination of both, ultimately, there will be no consequences for real estate owners. However, in all cases it would be true to say that if, in the period between two main assessments, changes occur that are relevant in terms of tax then these would have to be reported accordingly insofar as the local tax office had not already become aware of these.

Please note: The specific rules may vary depending on the German federal state or the model. So, for example, in Hesse, a main assessment is planned only once every 14 years while in Bavaria, Hamburg and Lower Saxony a main assessment at regular intervals is not envisaged.

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

Tax-neutral transfers between affiliated partnerships

Section 6(5) sentence 3 of the Income Tax Act *(Einkommenssteuergesetz, EStG)* legally specifies that in the case of the transfer of an asset between partnerships that are identical in terms of participation the hidden reserves would have to be realised. The Federal Constitutional Court *(Bundesverfassungsgericht, BVerfG)* recently concluded that this provision is not compatible with the Basic Law.

1. Background

According to Section 6(5) sentence 3 EStG, assets may be transferred at the carrying amount between different asset areas of certain partnerships (in particular, between total business assets and special business assets as well as between the special business assets of different partners) without payment or in exchange for maintaining or reducing company membership rights without hidden reserves having to be realised.

However, the transfer of an asset at its carrying value from the joint assets of a partnership to the joint assets of another such partnership in which the partners hold the same proportion of interests (partnerships that are identi-

cal in terms of participation) has hitherto been precluded.

2. Issue – Selling at the carrying amount to the affiliated partnership

In a dispute that was ultimately referred to the BVerfG, a GmbH & Co. KG [a German limited partnership with a limited liability company as a general partner] that operated commercially had sold two developed plots of land from its joint assets to an affiliated partnership that was identical in terms of participation at a purchase price that corresponded to the carrying values shown in the balance sheet. The selling company treated the transfer as not having an impact on income for tax purposes, whereas the local tax office argued that the sale had resulted in the full disclosure of hidden reserves.

The Baden-Wuerttemberg tax court, in its judgement of 19.7.2012 (case reference: 13 K 1988/09) ruled in favour of the claimants. In the opinion of the judges, it is possible to transfer an asset at its carrying value from the joint assets of a partnership to an affiliated partnership that is identical in terms of participation in accordance with Section 6(5) EStG. The Federal Fiscal Court suspended the appeal proceedings that had commenced on the initiative of the local tax office and referred the matter to the BVerfG.

3. Decision of the BVerfG

In its ruling of 28.11.2023 (case reference: 2 BvL 8/13) the BVerfG decided that the provision in sentence 3 of Section 6(5) EStG is not compatible with the Basic Law insofar as this clause precludes transfers at carrying values between partnerships that are identical in terms of participation, in particular, between affiliated partnerships.

The BVerfG even obliged lawmakers to put in place a new provision that would apply retroactively to transfers made after 31.12.2000 (!). Following the decision of the BVerfG, until such a new provision comes into force Section 6(5) sentence 3 EStG shall apply on the understanding that the provision will also be valid for transfers of assets between partnerships that are identical in terms of participation.

Recommendation

For ongoing cases, it would therefore be advisable to obtain the relevant changes to assessment notices without realising hidden reserves by making reference to the decision of the BVerfG.

White Cliffs of Dover

ACCOUNTING & FINANCE

Dr. Ulrike Engelmeyer / Henning Kruse

Measuring goodwill in times of inflation and a turnaround in interest rates

Against a background of persistent inflation and higher interest rates, the question of the real value of the goodwill on a balance sheet has gained particular relevance. The aforementioned developments can result in now having to make an unscheduled write-down of the carrying value of goodwill that was previously deemed to be its real value.

1. Introduction

Goodwill can be created on the balance sheet in the course of the acquisition of another company and constitutes an intangible asset that cannot be sold independently. In subsequent accounting periods, the Commercial Code (Handelsgesetzbuch, HGB) provides for scheduled amortisation of the goodwill that has been recognised in the balance sheet; however, under IFRS an annual impairment test has to be performed in order to determine whether or not a write-down is necessary.

Please note: An unscheduled write-down of goodwill would be required if the carrying value exceeds fair value (HGB) or the recoverable amount (IFRS).

2. Inflation and the rise in interest rates as risk factors for unscheduled write-downs

Impairment testing is currently of great importance in view of the persistent inflation and increased interest rates. This is because, in practice, the fair value or the recoverable amount is frequently determined by discounting the expected future cash flows of the under-

Chipping Campden in the Cotswold district of Gloucestershire

lying cash generating unit by an adequate rate for the cost of capital.

If the starting point is such a calculation of the value and a consideration of the nominal value then, in theory, taking inflation into account would generally result in higher future cash flows and – when considered separately – would have a value-enhancing effect. By contrast, the rise in interest rates would lead to higher rates for the cost of capital and have a value-reducing effect.

In practice, the projection of future cash flows is normally based on an integrated forecast plan. Taking inflation into account can result in price increases being taken into consideration in the anticipated expenses. It is questionable whether these price increases would even be fully reflected in the sales revenues. They could definitely have negative implications for margins and ultimately for the cash flows to be valued. Moreover, in the face of persistently high inflation and, at the same time, a rise in interest rates, macroeconomic expectations are more likely to be subdued and would furthermore result in rather pessimistic projections. Ultimately, the impact on the forecast of expected future cash flows will depend on the sector, the competitive environment and the ability of individual companies to quickly adapt to the changing general conditions.

Besides inflation and the macroeconomic conditions, the increasing rates for the cost of capital, in particular, will have a considerable impact on the measurement of goodwill. For example, the base rate of interest went up from 0.1% as at 31.12.2021 to 2.75% as at 31.12.2023. This implies an increase in the rates for the cost of capital that are used in the valuation calculations and a decrease in the company value or the market value of the equity capital. Insofar as the market value of the debt capital remains the same, the debt ratio will go up.

Lower cash flow forecasts as well as higher rates for the cost of capital could thus result in the carrying value of the goodwill no longer being covered by its fair value or recoverable amount and unscheduled write-downs would then be necessary.

Please note: As a result, these write-downs would reduce the equity on the balance sheet and, thus, the equity ratio of the company.

Conclusion

Admittedly, when performing an impairment test in respect of the goodwill on the balance sheet a case-by-case analysis is required. However, the observed factors could generally result in unscheduled write-downs of the goodwill. In particular, companies that prepare accounts according to IFRS, where goodwill is not amortised on a scheduled basis, have a greater risk here.

StB [German tax consultant] Julia Hörning / Nick Meder

Employee shares – Changes due to the German Future Financing Act

Many employers try to create motivation and retention incentives for employees via attractive remuneration packages that go beyond traditional salary payments. Employee shares could form part of such a package. They constitute an important instrument in the competitive market for highly skilled staff, in particular, for start-ups.

1. Taxation of employee shares

In 2021, a special provision was introduced, via Section 19a of the Income Tax Act *(Einkommenssteuergesetz, EStG)*, on the tax treatment of capital participations. This provision promoted the acquisition of real company shares where equity participations (e.g. shares or interests in a GmbH [German private limited company]) are directly transferred to employees. In contrast to this, there are also so-called virtual shares where the employees participate in the company's success via special payments that depend on how the business performs; however, here the employees do not receive any shares. In actual fact, few companies have made use of the provision that promotes transfers of real shares because employees were frequently faced with the problem of so-called dry income. What is meant here is when, from a tax perspective, the benefit from the participation that has been received is deemed to have already been realised even though the capital gain has not yet been paid to the employee. This would be the case, for example, when moving to a new employer or when a time-limit has expired. Consequently,

tax would have to be paid even though there has been no liquidity inflow. As a result, employees could be faced with considerable financial challenges.

The provisions relating to employee shares were adjusted and expanded via the Future Financing Act *(Zukunftsfinanzierungsgesetz, ZuFinG)*. The aim of the lawmakers was thus to mobilise more private capital, make Germany a more attractive financial centre and invigorate the equity culture in Germany.

2. Changes for start-ups due to the Future Financing Act

The aim of the changes is to create, in particular, better conditions for start-ups as well as for small and medium-sized enterprises (SMEs).

2.1 Defusing the dry income problem

With a view to defusing the dry income problem of Section 19a EStG, the ZuFinG provided for the adjustment or additions to the following provisions:

- Taxation of the non-cash benefits from capital participations at the very latest after 15 years instead of previously after 12 years (Section 19a(4) sentence 1 no. 2 EStG).
- In the case of a buy-back of the shares by the employer, solely the remuneration paid will be relevant and no longer the fair market value (Section 19a(4) sentence 4 EStG).
- No taxation after the end of the employment relationship or the back tax deadline if the employer declares that it is willing to assume responsibility for paying the payroll tax related to a subsequent sale (Section 19a(4a) EStG).
- Now, besides shares in a company itself, the more favourable tax treatment has also been extended to transfers of shares from shareholders to employees (Section 19a(1) sentence 1 EStG).
- The tax deferral will also be granted for shares with restricted transferability (Section 19a(1) sentence 3 EStG)

2.2 Broadening the scope of application

In addition to the deferred taxation provisions, the scope

Bath

of application of the rules has been broadened. In future, more companies will have the opportunity to benefit from the preferential treatment. It will be possible to make use of the privileges in future if the thresholds listed below have not been exceeded on the transfer date or in the six preceding calendar years. The founding date of a company may now already be 20 (previously 12) years ago (Section 19a(3) EStG).

Thresholds	Previously	Now
Annual revenues or total assets	max. €50m or €43m	max. €100m or €86m
Number of employees	250	1,000

2.3 Requirements linked to the type of participation

In order to be able to make use of the privileges, the employee has to hold an actual interest in the capital of the company and not just virtual shares. For example, in the case of a GmbH, an employee would have to be granted genuine capital interests; this would require an agreement authenticated by a notary. The privileges under Section 19a EStG would also apply if the interest is granted indirectly via a partnership – this is normally done by means of a simple written agreement.

Please note: The extension of the provision under Section 19a EStG to companies in a group where the staff member is not employed had been included in the draft of the legislation, however this was not implemented.

3. Changes for all companies

Apart from the provision described above for young companies, the tax-exempt amount for shares in the employer's company – which are obtained free of charge or transferred at a discount within the scope of the employment relationship – was increased generally for all companies, pursuant to Section 3 no. 39 sentence 1 EStG, from €1,440 to €2,000 per calendar year. Here, in contrast to Section 19a EStG, shares in companies defined in Section 18 of the German Stock Corporation Act are still privileged, too. This means that, for example, shares in group companies may also be transferred in cases where the member of staff is not employed.

IN BRIEF

Dismissal on the grounds of time fraud is possible even after unlawful data evaluation

The General Data Protection Regulation (GDPR) specifies, among other things, how video surveillance has to be run. In particular, it stipulates for how long the data may be stored and used appropriately. Nevertheless, video surveillance that breaches the general principles of data protection law can also result in a dismissal, as demonstrated by a dispute that was recently resolved by a labour court.

In a case that was decided by the Federal Labour Court *(Bundesarbeitsgericht, BAG),* in its ruling of 29.6.2023 (case reference: 2 AZR 296/22), a worker was employed at a foundry where there was video surveillance and this was also pointed out through appropriate signs. There was one day when the employee entered the business premises obviously with the intention of being paid for this day. Following an anonymous tip-off about employee time fraud allegedly on a regular basis, the employer had a look at the surveillance footage and found that the employee had left the works premises again even before the start of the shift. The employer considered this to be time fraud and dismissed the man.

The employee launched a legal action against the employer over unfair dismissal in the belief that he had worked on that day. Moreover, the surveillance videos were inadmissible as evidence and could not be taken into account in unfair dismissal proceedings. For this reason he even won his case in the lower courts.

However, the BAG took a different view. In unfair dismissal proceedings there is generally no prohibition on the use of such footage from overt video surveillance that is supposed to provide evidence of an employee's behaviour in deliberate breach of contract. This would even apply if the employer's surveillance operation did not fully comply with the requirements under the GDPR. Therefore, on these grounds the BAG referred the matter back to the lower court (the competent state labour court in Lower Saxony).

Determination of profit – Requirements for the recognition of deferred income

The Federal Fiscal Court *(Bundesfinanzhof, BFH)* recently considered the criteria for creating a deferred income item for period-related services.

Generally, when determining profits by the accrual basis accounting method, the business assets that have to be recognised for the financial year-end are the ones that have to be disclosed in accordance with German Generally Accepted Accounting Principles. In view of the need for a deferral to match the remuneration in terms of time ('certain period'), the still outstanding consideration has to be time-related or periodically divisible. If the time period over which the services owed have to be rendered is unknown then the extent to which the cash received has become income would not be clear.

The BFH, in its ruling of 26.7.2023 (case reference: IV R 22/20) has now highlighted, in particular, the following:

» An estimate of the 'certain time' as a precondition for recognising the cash received as deferred income would be permissible if it was based on 'generally applicable standards'. However, this is not the case if the standards that are used are based on the taxpayer's organisational decisions that could be changed.

» Payments received for a still outstanding period-related service cannot be recognised as liabilities under 'advance payments' but only subject to the conditions for deferred income.

Please note: Moreover, as a result of the 2022 German Annual Tax Act, reporting entities were granted an option (Section 5(5) sentence 2 of the Income Tax Act [Einkommenssteuergesetz, EStG]) according to which the recognition of a deferred item may be omitted if the respective expense or income does not exceed the amount in Section 6(2) sentence 1 EStG (= €800). The option applies for the first time for financial years ending after 31.12.2021 and has to be exercised consistently.

Moving house for a better home office – Relocation costs could be tax deductible

During the COVID-19 pandemic, many professionals with small homes realised that as a result of working from home they suddenly had a need for considerably more space. Consequently, in their tax return, one married couple from Hamburg deducted the costs involved in moving to a larger home as work-related costs. However, the courts have not yet reached a consensus on whether or not this is allowed.

In the specific case, the married couple lived in a 65 sqm apartment and during the COVID-19 pandemic (and afterwards) worked from home. The cramped conditions and the lack of workrooms proved to be problematic and so, in July 2020, the married couple moved into a 110 sqm apartment with two workrooms and not far from the previous apartment. In their tax return, the married couple deducted the relocation costs as work-related costs. However, the local tax office refused to allow this and made reference to the previously applicable principle according to which house moves could only be recognised as being job-related if, as a result, the journey to work was significantly reduced – by at least an hour.

Nevertheless, the Hamburg tax court, in its ruling of 23.2.2023 (case reference: 5 K 190/22), allowed the married couple to claim this work-related cost deduction and made reference to the new world of remote working. The judges who rule on fiscal matters were of the view that the move had resulted in a substantial improvement in working conditions and had made things easier and, therefore, it was job-related. It had been necessary to set up two workrooms in order to be able to perform the respective jobs. That was the reason for the move – enhancing living comfort had however not been a criterion for the married couple.

An appeal against this ruling is pending before the Federal Fiscal Court (Bundesfinanzhof, BFH) so that, for the time being, it remains to be seen how the supreme court will clarify this issue. Anyone who has borne the relocation costs in a similar case should, to begin with, deduct these as work-related expenses in their tax return.

Please note: If the local tax office refuses to allow this cost deduction then it would be possible to lodge an appeal with reference to the pending BFH case and to obtain a suspension of proceedings.

Discounting a purchase price paid in instalments – Interest and income from capital assets

When an item that forms part of private assets is sold and the claim for payment of the purchase price is deferred for the long term – i.e. longer than a year – until a certain point in time then the interest and income from capital assets could be taxable.

In the ruling by the Cologne tax court, of 27.10.2022 (case reference: 7 K 2233/20), on such a situation it was decided that the purchase price instalments that had been paid had to be divided up into the principal and interest components. The interest component constitutes income from other capital claims and is thus subject to income tax. This would also apply even if the parties to the agreement had not agreed a rate of interest or had in fact expressly ruled it out. It is also irrelevant that on the part of the purchaser the benefit derived from paying in interest-free instalments is subject to gift tax.

It is open to question whether the Cologne tax court has thus placed itself at odds with a 2011 ruling from the Federal Fiscal Court [Bundesfinanzhof, BFH] (of 12.9.2011, case reference: VIII B 70/09). At that time, the BFH had serious doubts as to whether an interest-free deferral of a claim for the equalisation of accrued gains between a married couple could result in an income tax liability for the interest component because, for gift tax purposes, the conditions for a generous gift had likewise been satisfied.

Please note: It thus remains to be seen what position the BFH will take in the appeal proceedings (BFH case reference: VIII R 1/23) on this situation where income tax law conflicts with gift tax law.

Stonehenge

AND FINALLY...

“Success is a shy deer. The wind has to be right, the weather conditions, the stars and the moon.“

Franz Beckenbauer (11.9.1945 – 7.1.2024) was a German football player, manager and official. He is regarded as one of the most important personalities in football history and as one of the best footballers of all time. Beckenbauer celebrated his greatest sporting successes together with the German national team that he captained from 1971. After winning the 1972 European Championship, he led the national team to triumph in the 1974 World Cup tournament, which was hosted by Germany. From 1984 to 1990 he was the team manager and during the 1990 tournament he likewise led the team as a coach to a World Cup triumph.

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