PKF newsletter

PKF
Accountants & business advisers

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Editorial

Dear Readers,

For a long time, cross-border activities of individuals and companies have proved to be difficult with regard to their tax treatment as the regulations of different legal systems and (tax) interests of the countries involved still have to be harmonised. Then again, to be internationally connected has become indispensable in business. Thus, avoidance strategies are of no use, so the only way forward is to try and clarify the many aspects of this difficult taxation issue. Therefore, starting with the Focus section in this issue, we have a new series of articles.

Furthermore, in an article on page 3 there are more answers to questions on cross-border taxation – a recent ECJ ruling has opened up new opportunities as part of a merger that, under certain circumstances, would allow the transfer of losses from a merged subsidiary to the parent company. Another article focuses on the transfer of business assets. On page 5, we discuss how assets can be gifted or bequeathed in a tax efficient way.

In addition, two articles deal with a frequently discussed topic, namely, the 1 % rule. On the one hand, this is now also applicable to staff bikes and, on the other hand, in cases where used vehicles are involved its application is not in compliance with the constitution. In any case, that is the current view of the BFH.

Together with the other interesting articles, we hope, once again, to have compiled relevant information for you.

Yours sincerely,

Your PKF Team

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FOCUS

Taxation of cross-border activities of employees – complex legal issues call for case-by-case assessments

As the number of employees working in other countries has increased, so have the tax issues associated with it. Thus, companies have to check, e.g. to what extent the obligation to deduct payroll tax applies to them. However, if a wrong assessment is made it can also result in considerable additional tax payments for the employee. In the first in a series of articles on this topic, in the following section we discuss the basic principles of the taxation of employees who are working in a foreign country but who are domiciled, or ordinarily resident in Germany.

Every employee domiciled or ordinarily resident in Germany is liable to pay income tax in Germany on his/her global income (full tax liability). There are, potentially, restrictions on this all-encompassing taxation laid down international treaties (double taxation treaties – so-called DTT). As Germany has concluded such treaties with more than 100 countries, in most cases, the DTT rules will normally apply. Nevertheless, in principle, a distinction has to be made as to whether, or not a DTT should be applied.

I. Taxation without the application of a DTT

Apart from exceptions such as particular activities within the scope of construction and assembly works, an employee is liable to pay tax in Germany on his/her entire income. Any foreign income tax that has been incurred can be offset against the corresponding German income tax for that source of income.

Recommendation: Instead of offsetting this amount the employee can apply to deduct the foreign tax. This can be more favourable, particularly, if losses have arisen.

II. Taxation in accordance with a DTT – Basic principle...

In most German DTTs, the right of the employee's country of residence to charge tax on the employee's income is *generally* precluded. Thus, wages and salaries earned from working in a foreign country are only taxed in the relevant foreign country in which the work is carried out.

In Germany, this income is often exempt from German income tax but counts for tax progression. However, in accordance with Section 50 d, para. 8 of the German Income Tax Act, this exemption can only be granted if the employee proves that the foreign tax that has been determined has also been paid, or that the other country has waived taxes.

Recommendation: There is a case pending before the Federal Constitutional Court against this strict rule (case reference: 2 BvL 1/12). Insofar as tax assessment notices, accordingly, are not issued on a provisional basis, you should then lodge an objection and make reference to this case and point to the suspension of proceedings.

III. ...or application of the 183-day rule

In contrast to the above-mentioned basic principle, according to the *183-day rule* the employee's country of residence has the sole right to tax income if all of the following preconditions are met:

- The employee is present in the country in which the work is carried out for less than 183 days.
- The employer is not based in the country in which the work is carried out.
- Remuneration is not paid by a permanent establishment of the employer in the country in which the work is carried out.

Days of presence include the arrival and departure days as well as all days of presence in the country in which the work is carried out immediately prior to, after, or during the

Which tax authority is looking forward to the tax receipts: the country of residence, or the country in which the work is carried out?

work (e.g. Sundays and public holidays) including days when there are work stoppages (e.g. a strike).

IV. Case-by-case reviews are advisable

Against the background of a number of DTTs concluded by Germany, it should be pointed out that different DTTs deviate from the rules described above, so e.g. the DTT with Belgium and the DTT with Denmark. Both do not apply the days of presence rule but, instead, the days of work rule. Therefore, it is advisable to conduct a separate review for each set of circumstances. In the course of this, besides taking into account the effects in terms of taxation in Germany, the tax implications in the country in which the work is carried out should always be taken into consideration.

More Information: A Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) circular, of 14.9.2006, has a useful summary of the income tax implications. This is available online at www.bundesfinanzministerium.de (German version only). We are going to discuss other particularities and aspects of cross-border taxation of employees in subsequent issues of the PKF newsletter.

TAX

Deductibility of loss carry-forwards in the case of cross-border mergers – are the possibilities that have been opened up by the ECJ useful?

Who for: German subsidiary companies and their parent companies in other EU States.

Issue: After a subsidiary company has merged with its parent company that is resident in another EU State, the subsidiary's tax loss carry-forwards are deductible in the latter state under certain conditions. For these new rules to apply, the ECJ set up certain preconditions:

- Firstly, the State in which the parent company is resident has to allow the possibility of transferring tax loss carry-forwards of the subsidiary to the parent company in purely domestic mergers. This is not the case in Germany and thus the ruling is irrelevant in the case of the merger of a foreign subsidiary with its German parent company. However, the law in some EU States (e.g. Finland, Austria) does include such a regulation, so that the merger of a German subsidiary with its Austrian parent company, for example, can be carried out without the forfeiture of tax loss carry-forwards.
- Secondly, the losses at the subsidiary company have to be so-called "final losses". Therefore, proof will be to have given that the losses in the State where the subsidiary is established have neither already been taken into consideration, nor will they be taken into account in the future.

Recommendation: Verification of the finality of losses, in particular, often presents enormous difficulties. Insofar as you are aiming to utilise the tax loss carry-forwards of a transferring company, within the scope of a cross-border restructuring, you should clarify the details, in good time, with your PKF consultant.

More Information: The ECJ ruling discussed above is from 21.2.2013, in the proceedings brought by A Oy (case reference: C-123/11) and is available online at curia.europa.eu.

1 % taxation rule is also applicable to staff bikes

Who for: Taxpayers who are provided with staff bikes for private use as well as their employers.

Issue: According to previous regulations, the non-cash benefit derived from the private use of a staff bike was valued at the final price, taking into consideration the usual discounts, that was charged for use at the drop-off location. The monthly tax exemption limit for benefits in kind of € 44 could be applied. The application of the 1 % rule – relevant for company cars – was only applicable for electric bikes which, according to transport regulations, are classified as motor vehicle (e.g. those whose engines assist speeds of more than 25 km/h). According to a recent decree of the tax authorities, this so-called company car privilege, the 1 % rule, now also applies with immediate effect to all bikes that are not subject to compulsory registration and insurance cover. Backdated to 2012, the average monthly value of private use will be based on 1 % of the manufacturer's, importer's, or wholesaler's recommended retail price, rounded off to the nearest € 100 (at the point in time when the bike came into service, including VAT). Besides private journeys, this monthly value even

includes journeys between home and the regular place of work. The tax exemption limit for benefits in kind is no longer applicable.

Recommendation: If a(n electric) bike is provided on the basis of salary conversion, or instead of a salary increase, then depending on the salary and the tax code of the employees who are cycling enthusiasts, it might be possible to generate advantages with respect to tax and social security. From a tax point of view, everything is covered with an annual contribution of 12 % of the gross list price.

More Information: For companies where the provision of bikes to customers is part of the range of offerings there are different rules. We would be happy to provide you with the coordinated decree issued by the federal states, of 23.11.2012, upon request.

Used vehicles – 1 % rule applicable but frequently disadvantageous

Who for: Taxpayers who are provided with used motor vehicles as company cars for private use as well as their employers.

Issue: When applying the so-called 1 % rule, even in the case of a used vehicle that has been purchased by the employer, it is the gross list price of the vehicle when new that is the decisive variable for the calculation. This was recently clarified (once again) by the Federal Fiscal Court (*Bundesfinanzhof*, BFH). In the case in question, the claimant also had the private use of a company car, which was a leased used car. The value of the used car, at the time of purchase, was around € 32,000 while the gross list price when new was € 81,400. Therefore, the lump sum valuation of the benefit of use calculated on the basis of the gross list price exceeded significantly the lease rate paid by the employer.

In this case, too, the BFH held that there was no constitutional objection to the application of the 1 % rule. Firstly, it is not solely the value of the company car itself that has to be taken into consideration in the benefit of use calculation but also any assumption of costs in connection with the use of a company car. Moreover, the application of the rule can be avoided by keeping a proper driver's log book. Therefore, it is not a problem that used cars have depreciated a lot in value and, actually, when cars are bought new the manufacturer's list price is only paid in exceptional cases. In this respect, the German government does not have to make any valuation adjustment in the tax regulations.

Recommendation: In the case of used cars there should be a detailed review to ascertain whether, or not it would make sense to keep a driver's log book. In this way the amount of expenses that arise in connection with private, or business use can be documented exactly and, possibly, unfavourable flat-rate taxation can be avoided.

More Information: The BFH ruling of 13.12.2012 (case reference: VI R 51/11) can be downloaded at www.bundesfinanzhof.de (German version only).

VAT groups – the BMF has revised its view of the organisational integration criterion

Who for: Companies with subsidiary corporations as well as the subsidiary corporations themselves.

Issue: If a legal entity (subsidiary company) is integrated financially, economically and organisationally into the business of another company (parent company) then the legal entity and the other company will be regarded as a single company for VAT purposes. The important consequences of this taxable group consolidation are that VAT is not chargeable on transactions between the parent company and the subsidiary company and the parent company only has to file a single tax return.

In principle, organisational integration implies common directorships in the governing bodies of the subsidiary company and the parent company. Ideally, they should be the same people. In line with a more recent Federal Fiscal Court (*Bundesfinanzhof*, BFH) ruling, the tax authorities – according to a new Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) circular – do now, indeed, want to recognise organisational integration if a subsidiary company has managing directors who are not in the governing bodies of the parent company. In this case, however, it would also be necessary to ensure that there can be no question of the actions of the subsidiary company being contrary to the wishes of the parent company – for example, through the design of the management authority structure. Whereby, circumstances that would not sufficiently ensure organisational integration could be, e. g.

- where the controlling company's scope for intervention is based solely on supervisory authority (by means of a shareholder's resolution) related to owning an interest, or
- if the management regulations of the shareholders' meeting provide for reservations of consent.

Recommendation: The tax authorities want to apply the new interpretation retroactively, backdated to 1.1.2013, for all open cases. Insofar as the companies concerned, having made reference to the guidelines up to now, had assumed that organisational integration did exist, there will be a transitional period up to the end of 2013. Therefore, it is necessary to check the extent to which the changes affect you and whether, or not you want to make use of the transitional period. Furthermore, it should be decided whether use should be made of the corresponding structuring possibilities in order to be able to create organisational integration for the future, or otherwise to avoid it. PKF would be delighted to help you with any of these issues.

More Information: The new BMF circular of 7.3.2013 can be found at www.bundesfinanzministerium.de (German version only). The BFH ruling that was mentioned is from 7.7.2011 (case reference: VR 53/10) and is available at www.bundesfinanzhof.de (German version only).

Gifting/bequeathing business assets – decrees issued by the German federal states provide clarity for multiple-tier business structures

Who for: Potential as well as actual donors and beneficiaries of, or legal heirs to business assets.

Issue: If a business that has more than 20 employees is transferred by way of gifting or bequeathing, an 85 %, or 100 % tax exemption for the business assets depends, in principle, on whether, or not within five or seven years, the aggregate wages of the transferred assets represent 400 % and 700 %, respectively, of the aggregate wages prior to the transfer. Exactly which employees and which expenses are included in this calculation are of great significance with respect to tax planning.

In the new decrees, the tax authorities have disclosed their opinion on, among other things, employees of downstream affiliate/subsidiary corporations in Germany, the EU, or the EEA. These shall only be included if the size of the shareholding is more than 25 %. In particular, the following shall apply:

- the calculation of the quota shall be carried out taking a multiple-tier view – besides direct shareholdings, indirect shareholdings shall be included in each case.
- It has to be possible to include the employees of the downstream affiliate/subsidiary corporation, on a pro-rata basis, over the entire monitoring period even if the shareholding is only initially more than 25 % and then subsequently falls below this limit.

Recommendation: The decrees provide a basis for new options such as streamlining the interests held in corporations during the monitoring period. However, various issues with regard to stakes in companies outside of the EU, or the EEA remain unresolved. Therefore, before you "park" German, EU, or EEA shareholdings in companies in a third state, you should clarify the effects, in good time, with your PKF consultant

More Information: The decrees issued by the German federal states on 5.12.2012 can be found at www.bundesfinanzministerium.de (German version only). For further discussions, please see the article by PKF authors Jacobs/Kämper in the 12/2013 issue of DER BETRIEB (a German periodical) in the special section on Succession Planning, p. M10 – M12 (German only).

ACCOUNTING

Accruals for future tax audits recognised in the tax accounts – how should these be valued?

Who for: Companies that are subject to a follow-up tax audit (so-called large enterprises as defined in the tax audit ordinance).

Issue: A large enterprise has to make accruals for the costs it expects to incur during future tax audits, even if it has not received a tax audit notice, if on the appointed date these costs already relate to a previous financial year (according to a recent Federal Fiscal Court (*Bundesfinanzhof*, BFH) ruling, cf. issue 11/2012). This is due to the fact that large companies are always and continuously subject to tax audits. The general applicability

of the principles of the ruling has now been confirmed in a Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) circular. However, the circular also clarifies that in the case of businesses where a follow-up tax audit can be ruled out, such a provision for future external audits may not be created.

Furthermore, the BMF also gave its view on the question left open by the BFH, namely, which costs should be taken into consideration for the valuation of the accrual. According to this, only those costs directly linked to the expected audit can be included. The valuation for the tax accounts should be carried out on the basis of individual costs plus the appropriate share of the necessary overhead costs. The amount based on the value ratios on the appointed date then has to be discounted by a rate 5.5 % up to the likely start of the tax audit.

Recommendation: The BMF wants to apply these principles to all the cases that are still open. Therefore, the regulations pertaining to the adjustment of the accounts have to be observed. There are different valuation rules for financial accounts, thus it is likely that deferred taxes might arise.

More Information: The new BMF circular of 7.3.2013 as well as the current size classification (BMF circular of 22.6.2012) can be found online at www.bundesfinanzministerium.de (German version only).

LEGAL

Statutory termination due to rent arrears – BGH has provided a clear limit

Who for: Landlords of residential premises with tenants in rent arrears.

Issue: Landlords who rent out residential premises for an indefinite period have to present a legitimate interest if they wish to give statutory notice of termination of a contract. A legitimate interest could be, e.g. own use requirements but also a culpable and material breach of payment obligations by the tenant. Up to now, it had been presumed that even in cases of outstanding payments, a contractual notice of termination was only possible if the following statutory limits for an extraordinary and immediate termination had been exceeded:

- a material amount of the rent is not paid on each of two consecutive dates, or
- the sum of the rent arrears amounts to at least two months' rent.

In a recent ruling, the Federal Court of Justice (*Bundesgerichtshof*, BGH) clarified that these limits are not applicable for statutory termination with notice. At the same time, it defined when rent arrears are deemed to be not so material as to provide a legitimate interest for a contractual termination. According to this, the arrears may not yet exceed one month's rent and the duration of the arrears has to be less than one month.

Recommendation: However, if both of these two values are exceeded, you can claim a legitimate interest in a contractual termination. Insofar as you have defaulting tenants, before you send a termination based on the above-mentioned limits, stipulated from now on, check which type of termination is possible at which point in time.

More Information: The BGH ruling of 10.10.2012 (case reference: VIII ZR 107/12) is available at www.bundesfinanzhof.de (German only).

A contract with a GbR (company/partnership under German civil law) can effectively be concluded by only one partner

Who for: Parties involved in a *Gesellschaft bürgerlichen Rechts* (GbR).

Issue: A law firm set up as a GbR had concluded a commercial lease contract for a fixed lease term of ten years. A few years later, the GbR gave notice of the early termination of the lease contract and pointed out that the lease contract had not been concluded effectively as only one of the partners had signed with the use the company stamp.

However, the Federal Court of Justice (*Bundesgerichtshof*, BGH), in a recent ruling, took a different view. The conclusion of a written lease contract does not imply that all the managing partners of a GbR have to sign. The firm can be represented by just one authorised partner, in which case the declaration of the authorised representative becomes effective when it is accompanied by an

additional designation indicating the representative relationship, from which it is clear that no other signatures required for an effective representation are missing. In the case in question, the BGH took the view that the use of a company stamp was in itself sufficient as an additional designation, as in business transactions a legitimising effect is ascribed to it. There is no doubt about the completeness of this form of declaration and it also meets the written form requirement.

Recommendation: In practice, it is still important for a GbR to pay particular attention to the signing of contracts that have a written form requirement. Insofar as not all the partners sign, it should nevertheless be made clear that the signatories are acting on behalf of the other partners. A supreme court decision, moreover, has now clarified that the use of a company stamp is already sufficient as an indication of this.

More Information: The BGH ruling of 23.1.2013 (case reference: XII ZR 35/11) can be viewed online at www.bundesgerichtshof.de (German version only).

CORPORATE FINANCE

Crises and insolvencies in group structures – how can these particular challenges be overcome?

Who for: Corporate groups undergoing a complete, or partial economic crisis.

Issue: If individual parts of a corporate group are thrown into crisis this can quickly radiate to other group companies that were previously economically sound if, in integrated group structures, functions that are of relevance to the healthy companies, such as purchasing, sales or finance, can no longer be fulfilled by the companies in crisis, e.g. as a result of their insolvency. If the organisational unit of the relevant function is already insolvent, or if this is impending, in order to prevent cascading effects, frequently, the top priority is to compensate for the loss of the relevant function. Given that in the context of decentralised group structures – which are also often encountered in today's SMEs – such a scenario frequently affects a whole series of other group companies, if possible, efforts to resolve the situation should be coordinated between the remaining companies. However, often, the economic problems of a functional organisational unit start to emerge over a longer period of time and, in contrast to external service providers, say, the head office in principle does have access to information about the development of the crisis.

Therefore, the group's management would usually be well advised to closely monitor the economic development of those companies that are essential to the survival of the entire group, in order to be able to look for possible solutions long before an existential crisis occurs in these parts of the group.

However, in the process of managing crises at group structures, it would be shortsighted to focus only on the companies that are (still) sound. With the German Law to Facilitate the Restructuring of Companies (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*, ESUG) (the second phase of the so-called great reform of the insolvency law that came into force on the 1.3.2012, cf. issues 2/2012 and 4/2012 of the PKF Newsletter) the practical significance of self-administration has in fact increased, whereby, under certain conditions, a company's existing management can apply for so-called protective shield proceedings and can continue to manage the company, for a limited period of time, under the supervision of a trustee in order to develop and roll-out restructuring measures for the company.

Nevertheless, the applicable insolvency law is aimed at dealing with insolvencies of single, legal units. The particularities of group structures, however, are only taken into account to a limited extent, especially with respect to a coordinated approach in the context of insolvency administration of group companies. Thus, insolvency proceedings carry the risk that uncoordinated measures of different insolvency administrators lead to unwanted or suboptimal results for the group as well as for the creditors.

Recommendation: Therefore, in order to avoid the latter risk concerning insolvent group companies, the aim should be to appoint one and the same person as the insolvency administrator for all the insolvent companies of a group. However, currently, it might prove difficult if the insolvent companies are located in different places with different jurisdictions so that coordination between several courts is necessary.

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More Information: To overcome the particular difficulties of insolvency proceedings in group structures, in January of this year, the Federal Ministry of Justice (*Bundesministerium der Justiz*, BMJ) presented a draft discussion paper on further adjustments to insolvency law. In this paper, among other issues, it is proposed that, upon application, there should be one place of jurisdiction as well as the appointment of a common insolvency administrator for all the group companies concerned. Furthermore, the draft paper also contains suggestions for cooperation rights and duties between the parties to the insolvency proceedings as well as for a special coordination procedure (the draft discussion paper can be found online at www.bmj.de; German version only). We will keep you informed about the progress of any discussions although, given the current status, it is unlikely that these proposals will be adopted in 2013.

IN BRIEF

PKF Issues – Public Sector series

Edition 1/2013 of the PKF Issues – Public Sector series was recently published. Besides the various new legal provisions that give rise to a need for action for transport companies as well as for utility companies, in particular, the topic of consolidation of municipal budgets is discussed and a holistic approach to solving problems is presented. In addition, there is a discussion of current accounting and tax issues, such as e. g. with respect to consolidated tax filing status and sponsoring (available at www.pkf.de – German version only).

AND FINALLY...

"Often, a small salary increase is already enough and, once again, you can afford the last tax increase !"

Sandro Paternostro, Italian journalist and television presenter, 1922 – 2000

Impressum

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