PKF newsletter

PKF
Accountants &
business advisers

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Editorial

Dear Readers,

The legislative process for the Annual Tax Act 2013, or its replacement (cf. the articles on this in issues 11/2012 as well as 2/2013) has still not been completed – in any case, not by the time this newsletter went to press. However, in the meantime and largely unnoticed by the public, two especially important changes to tax laws have been passed in a separate law and have now come into force. On the one hand, dividends distributed by corporations will be subject to corporate income tax at the level of the recipient if the latter holds less than 10% in the company making the distribution. On the other hand, regulations will be introduced whereby capital gains tax on certain dividends distributed by domestic German corporations will be refunded to their foreign shareholders. In the Focus section of this issue you can read more about the new law.

The subsequent tax and accounting topics look at current developments in jurisdiction and tax administration that are, e. g. of significance for landlords. Furthermore we would like to draw your attention to the fact that additional options for restating tax accounts have been introduced. In addition to that, we continue with the series of articles, which began in the last newsletter, on the taxation of employees who work across borders. In this issue we discuss the particularities for cross-border commuters.

Our business management topic in this issue is devoted to working capital management. On p. 7 you can read more about how tied-up capital can be optimised by influencing short-term capital as well as the current assets in normal operations.

We hope that the information in this newsletter will prove to be very useful.

Yours sincerely,

Your PKF Team

FOCUS

Amended regulations with respect to corporate tax income liability on free-float dividends

Already in 2011, the ECJ declared that it was in violation of European law to levy German capital gains tax on free-float dividends distributed to corporations in other EU States while German corporations, that were recipients of dividends, usually benefited from the tax exemption that is afforded to such distributions (cf. issue 3/20012). The German government has now reacted with amended legislation.

We would like to highlight two particular regulatory areas:

- Firstly, dividends from shareholdings of less than 10% (holdings in the shares that are freely traded) received after 28.2.2013, including (also) dividends received by domestic German corporations, will be subject to tax.
- Moreover, the legislation now regulates the refund procedure for capital gains tax previously (thus, before 28.2.2013) wrongly withheld from foreign recipients of dividends.

I. New tax liability for free-float dividends depends on size of shareholding

If, at the beginning of a calendar year, the shareholding of a corporation in the share capital of a dividend-paying corporation is less than 10%, then the dividends from this shareholding are liable to corporate income tax. On-going expenses related to the shareholding (e.g. financing costs) can be deducted when determining the taxable income. This also applies to years in which no dividends are distributed. Gains from the divestment of such shareholdings remain exempt from corporate income tax and, conversely, any items related to this shareholding that emerge and that could lead to a reduction in profits (e.g. disposal losses or writedowns) are not permitted to impact taxable income.

Thus, the size of the shareholding determines whether, or not the dividends are liable to taxation. Various individual provisions apply here.

- The calculation includes only shares held directly by the corporate recipient as well as indirect shareholdings, but these only to the extent that they are attributable to this company through tax transparent partnerships.
- Other rules are concerned with changes to shareholdings.
  - Thus, e.g. a shareholding of at least 10% acquired during the course of the year is treated as if it had been acquired at the beginning of the year.
  - By contrast, if during the course of the year an existing holding in shares that are freely traded is increased to at least 10%, this does not lead to a 10% shareholding being assumed from the beginning of the calendar year.

Recommendation: Therefore, accordingly, caution is required with respect to such structuring. Furthermore, irrespective of this, German corporations with holdings in the portion of shares that are freely traded should review (or commission a review) as to what extent the corporate income tax liability of dividends could be avoided by restructuring. In such cases, it might be possible to aggregate fragmented holdings by, for example, transferring shares, or through the use of commercial partnerships. For advice please do not hesitate to contact your PKF consultant.

II. Procedure for refund of capital gains tax on "old" free-float dividends

Based on the above-mentioned ECJ ruling, EU/EEA corporations that are recipients of free-float dividends from German corporations are entitled to a refund of the capital gains tax, insofar as the dividends were paid out before 1.3.2013. From now conditions and procedures for this refund are regulated by law. The preconditions that the recipient has to fulfil for a refund include:

- its headquarters and management have to be within the EU/EEA
- and it has to have fully tax liability in a foreign country,
- it holds a direct shareholding in the company distributing the dividend and,
- in the case of full tax liability, the dividend would have been received tax-free.

The refund is made by submitting an application to the German Federal Central Tax Office. In this application, there has to be evidence that the preconditions for the refund have been fulfilled. The refund is only possible within four years after the end of the calendar year in which the dividends were paid.

Recommendation: The above-mentioned deadline requires quick action to be taken, if necessary. If you would like a refund of the tax on dividends distributed in 2009, you should contact your PKF consultant without delay as it will only be possible to submit an application for a refund in 2013.

TAX

Corporate Taxes

VAT on food and drinks – who is allowed to apply the reduced tax rate?

Who for: Companies that distribute food and drinks as well as their customers.

Issue: The distribution of food prepared for immediate consumption can be either deliveries that fall under a reduced VAT rate of 7% (supply of food), or, however, other deliveries that fall under the standard VAT rate of 19% (catering services). A catering service should be presumed if the quality of the service component predominates within the overall circumstances in which the food is presented. Otherwise, delivery services are assumed which fall under the reduced tax rate.

Following on the heels of a new ruling, the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) has revised its opinion on this frequently discussed topic. According to an administrative directive, published on 20.3.2013, the following service elements, among others, qualify the distribution of food as a catering service as they are not necessarily linked to the sale of the food:

- the provision of a support infrastructure for catering (e. g. guest dining rooms, cloakrooms and customer lavatories as well as tables, chairs and benches),
- serving food and drinks,
- the provision of waiting staff, cooks and cleaners, or performing a featured service, waiting services or washing up services for customers,
- granting use to customers of crockery or cutlery,
- furniture hire for customers (e. g. tables, benches, chairs).

Recommendation: With the help of 16 clearly explained examples of eligibility criteria, the BMF implicitly shows possible ways of obtaining the reduced VAT rate. The businesses concerned have the option of either applying the regulations retroactively, backdated to 1.7.2011, or applying them for the first time from 1.10.2013.

More Information: The BMF circular of 20.3.2013 is available at www.bundesfinanzministerium.de (German version only). We would be happy to provide you with the previous ECJ and Federal Fiscal Court (*Bundesfinanzhof*, BFH) rulings, upon request.

Energy tax relief for small-scale CHP plants – BMF letter of implementation with respect to Section 53 a of the Energy Tax Act

Who for: Operators of small-scale combined heat and power plants (CHP plants).

Issue: Up to 31.3.2102, small-scale CHP plants with electric power output of up to 2 MW were exempt from energy tax. In the meantime, a follow-up regulation has come into force, with Section 53 a of the Energy Tax Act, and has been backdated to 1.4.2012. The Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) circular, of 26.3.2013, has clearly set out the view of the authorities and the regulations focus on two particular points.

The preconditions for claiming full exemption from energy tax for these plants are, among others, that the CHP plant has to be highly efficient and achieve a monthly or annual usage rate of at least 70%. A new requirement, compared with the previous regulations, is that particular CHP plants have to lead to primary energy savings of at least 10% compared with non-integrated heat and power generation systems. This requirement relates to plants with electric power output of between 50 kW and 2 MW.

Moreover, the exemption from energy tax is now only granted for a limited time, namely, the depreciation period for tax purposes of the main components of the plant. Nevertheless, there is an entitlement to a partial tax exemption if CHP plants that have already been depreciated, or are not highly efficient meet the criterion of a monthly or annual usage rate of at least 70%.

Recommendation: As the new regulations have now come into force, exemption applications can be submitted accordingly. In this respect, an application for exemption has to be submitted annually for each plant. Applications for exemptions for 2012 have to be submitted by 31.12.2013. The annual tax return should be submitted

without delay as the deadline is 31.5.2013. Even though the BMF circular addressed the main issues, you should take into account other possible regulations in the Energy Tax Ordinance (Energiesteuerverordnung, EnergieSt) expected to be published this spring.

More Information: The BMF circular of 26.3.2013 is available at www.bundesfinanzministerium.de. (German version only). Please do not hesitate to contact your PKF consultant if you have any questions on this and on the forthcoming EnergieStV.

Personal Taxes

Guarantee obligations as subsequent acquisition costs of shareholdings

Who for: Taxpayers with at least 1% of their private assets invested in a corporation and who, on account of their corporate relationship, have entered into a guarantee commitment.

Issue: A shareholding managing director with a 50% interest in a GmbH (German limited liability company), settled one of this company's debts arising from guarantee that he had assumed on its behalf after its termination. In this case, payment was made in equal yearly instalments. The Federal Fiscal Court (*Bundesfinanzhof*, BFH) recently confirmed that such liabilities relating to a shareholder's guarantees should, in principle, be recorded at nominal value as subsequent costs relating to the shareholding and they increase the shareholder's liquidation loss accordingly. However, a debt, related to a guarantee, that has to be paid in instalments, should only be taken into account at its present value. This even applies in cases where interest payments have been expressly ruled out.

Furthermore, the BFH ruled that a reduction in the instalments that have to be paid that is agreed several years later shall be classified as an event with retroactive effect. The reason for this is that the extent of the actual use that is made of the guarantee commitment has a retroactive effect on the liquidation proceeds of the GmbH. Consequently, there has to be a reduction in the shareholder's original (subsequent) acquisition costs of the shareholding.

Recommendation: If a reduction in an instalment payment agreement is pending, a review should always be made to determine whether, or not the liquidity advantage that is gained is outweighed by the tax consequences of a subsequent increase in a disposal gain, or a reduction in a loss on disposal.

More Information: The BFH ruling discussed above from 20.11.2012 (case reference: IX R 34/12) can be downloaded at www.bundesfinanzhof.de (German version only).

Are exceptional impairments in the value of rental property tax deductible?

Who for: Owners of property that is rented out.

Issue: Within the scope of rental income, it is only possible to deduct impairments in the value of buildings beyond that of the normal depreciation level in special circumstances. The German Income Tax Act provides for the possibility of depreciation in the event of an extraordinary deterioration in economic value ("*Absetzungen für außergewöhnliche wirtschaftliche Abnutzung*", AfaA) in exceptional cases only. Here, a reduction in profitability in itself is usually not a sufficient reason. What is required is, rather, an external event that has a direct "tangible" impact on the asset and limits its possible use.

The Münster Tax Court recently rejected the tax deductibility of so-called AfaA in a case where, after the main tenant had given contractual notice of termination, it was not possible to rent out the property in question, or at least only at a rental level that was far below the previous one. While the taxpayer had given as a reason the fact that the property had been entirely customised to the needs of the main tenant and, thus, with regard to influencing factors such as size of rental area, location and parking possibilities it was considerably less attractive for comparable tenants. However, the tax court did not go along with this. It traced the difficulties of the claimant to rent out the property once again at the original rental level, after the main tenant had moved out, mainly to the negative development of the environmental factors related to the location of the rental property.

Recommendation: In a Federal Fiscal Court (*Bundesfinanzhof*, BFH) ruling, on 17.9.2008, expectations had been raised that, within the scope of rental income determination, it would become possible to deduct exceptional impairments to a greater extent than previously permitted. It should, therefore, be interesting, in the appeal pending against this decision (case reference: IX R 7/13), if and

how the BFH substantiates its view, based on the circumstances in which the Münster tax court made its ruling. Therefore, similar cases should be kept open, if possible.

More Information: A commentary on the ruling of the Münster tax court of 24.1.2013 (case reference: 11 K 4248/10 E) by PKF author Ralph van Kerkom is available. It was published in the German language periodical *Betriebs-Berater* (2013 p. 688). The BFH ruling discussed above, from 17.9.2008, (case reference: IX R 64/07) is available at www.bundesfinanzhof.de (German version only).

Cross-border taxation of employees – particularities for cross-border commuters

Who for: Cross-border commuters and their employers.

Issue: From a tax point of view, cross-border commuters are those employees who work within the border area of one country but live in the border area of a neighbouring country and, as a rule, return to their home on every working day. In principle, the normal taxation rules apply to cross-border commuters (cf. Focus article in issue 04/2013). However, the German double taxation treaties (DTTs) with Austria, France and Switzerland have different special rules for cross-border commuters. Accordingly, the right to tax is conferred on each employee's country of residence (= state of domicile) if the employee presents a certificate of exemption from his/her state of domicile. Furthermore, specific preconditions have to be met according to the relevant DTT.

- **France and Austria –** Cross-border commuters are all those employees who live and work within the border zone. The border zone comprises a strip within 30 km on either side of the border (Austria), or 20 km (France – for French employees who work in Germany, 30 km on the German side). The cross-border commuters' rule applies only in cases where the employee does not return home for a maximum of 45 working days and/or works for his/her employer outside of the border zone (so-called days of non-return).
- **Switzerland –** Cross-border commuters are all those employees who live in one of the countries and work in the other.

In addition, the cross-border commuters' rule includes a pre-condition of a maximum of 60 days of non-return per calendar year.

If the preconditions of the Swiss cross-border commuters' rule are fulfilled, the employer of the country in which the work is carried out is permitted to deduct a maximum payroll tax at a rate of 4.5%. The remuneration is taxed in the country of residence and the payroll taxes that have been withheld at source are offset. For France and Austria, the country in which the work is carried out does not have the right to tax if the preconditions for the cross-border commuters' rule have been fulfilled.

Recommendation: With a view to applying the appropriate taxation, employers and employees should pay particular attention to the days of non-return and, in the event of the relevant limit being exceeded, they should assess and discuss the consequences without delay.

More Information: Compared with the cases presented in issue 4/2013, the application of the cross-border commuters' rules discussed in this issue usually leads to completely different tax charges. In the next issue of the newsletter we will again return to the topic of cross-border taxation of employees with a look at other aspects.

ACCOUNTING

Additional options for restating tax accounts – the BFH has abandoned the subjective error concept.

Who for: Companies that prepare tax accounts.

Issue: If a company submits inaccurate tax accounts to its local tax office then these can be restated (unless these are the basis for a tax assessment that, for reasons of legal procedure, can no longer be repealed or modified). To-date, it appeared to be clear in which cases the tax accounts would be considered not to be accurate. Up to now, the tax authorities were not allowed to correct the tax accounts if an assessment was, indeed, objectively wrong (objective error) but the taxpayer could not have detected this when preparing the tax accounts, dutifully and conscientiously, based on the available knowledge (subjective error).

In a recent ruling, the Grand Senate of the Federal Fiscal Court (*Bundesfinanzhof*, BFH) abandoned this view. Accordingly, it is possible to correct tax accounts, without

the above-mentioned restriction, if there is an objective error. The change in jurisdiction has various effects.

- On the one hand, in matters of taxation, the tax authorities are no longer bound by the tax accounts of the taxpayer if these were justifiable, at the point in time when the accounts were prepared, but turn out to be objectively wrong. If the tax authorities had used the concept of subjective error in tax assessments to-date, they are nevertheless prevented from changing these tax assessments based on the new jurisdiction since the tax payer can legitimately rely on the former jurisdiction.
- On the other hand, companies will be able to benefit more easily or more quickly from advantageous developments in legal rulings, or from facts that become known later. It will no longer be assumed that a previous, subjective miscalculation has been made, there will only be an objective view.

Recommendation: In order to fully benefit from the ruling in future all developments in legal rulings would have to be examined with regard to the possibilities for restating the tax accounts. However, such extensive monitoring is, naturally, not possible in practice. Nonetheless, amendments important for your company should be reviewed with respect to the extent that a restatement of the tax accounts and, based on that, of the tax assessments for the past, is possible. Please do not hesitate to contact your PKF consultant in this regard.

More Information: The above-mentioned BFH ruling, of 31.1.2013, (case reference GrS 1/10) can be found at www. bundesfinanzhof.de (German version only). Other issues related to amendments to, and restatements of, financial and tax accounts are discussed by PKF author Dr Dietrich Jacobs in the German language accounting manual *Beck'sches Handbuch der Rechnungslegung* (Section B 102).

LEGAL

More restrictive framework for the deployment of temporary workers

Who for: Employers who engage temporary workers.

Issue: The framework for the deployment of temporary workers was tightened further in two recent Federal Labour Court (*Bundesarbeitsgericht*, BAG) rulings so that, in particular, long-term deployment of temporary workers in a company is becoming increasingly unattractive. Thus, temporary workers should be included with regard to the question whether or not the Employment Protection Act is applicable and in order to determine the number of works council members.

Generally, legal protection against dismissal normally applies to employees that work in companies that regularly employ more than 10 employees. To-date, the deployment of temporary workers had no impact on the size of the workforce used to determine the number of works council members, as the deployment – in accordance with the aim of the legislation – should be temporary. In future, however, a distinction will have to be made. When determining whether or not a threshold has been reached in workforce numbers, temporary workers have to be included if "they are regularly needed as staff members." With this wording, the BAG judges have taken into account the usual number of personnel that should be available without actually engaging temporary workers. Thus, the consequence of the BAG ruling is that in micro-entities where temporary workers are deployed, from now on, the core workforce could be entitled to legal protection against dismissal.

According to another BAG ruling, as a general rule, temporary workers who are engaged "on a regular basis", will, in the future, also be included, in order to determine the size of the works council at the company that has hired them. Thus the use of temporary workers could affect the number of works council members and thereby also, of course, the number of works council members that have to be released from work.

Recommendation: As the rulings take into account "the usual number of personnel" at the hiring company, caution is required if temporary workers are deployed, effectively, on a permanent basis in order to perform core task. The consequences should be reviewed carefully in order to avoid unpleasant surprises afterwards. In any case, it should be no problem to employ agency workers as temporary replacement staff (for example, to cover absences due to sickness or holiday).

More Information: The BAG ruling of 24.1.2013 (case reference: 2 AZR 140/12) as well as the BAG ruling of 13.3.2013 (case reference: 7 ABR 69/11) can be found online at www.bundesarbeitsgericht.de (German version only).

CORPORATE FINANCE

Optimising finance through Working Capital Management

Who for: Companies with large amounts of capital tied up in stocks and receivables.

Issue: An important indicator of a company's capital requirement is Working Capital. It corresponds to the portion of current assets that are subject to long-term financing. Working Capital is calculated by taking inventories (incl. short-term receivables, in particular, trade receivables) and subtracting from them the non-interest bearing current liabilities (in particular trade payables). Whereby, the Cash Conversion Cycle (CCC) is the key parameter through which a company can manage its net tied-up capital. A brief overview of this CCC can be seen in the figure opposite.

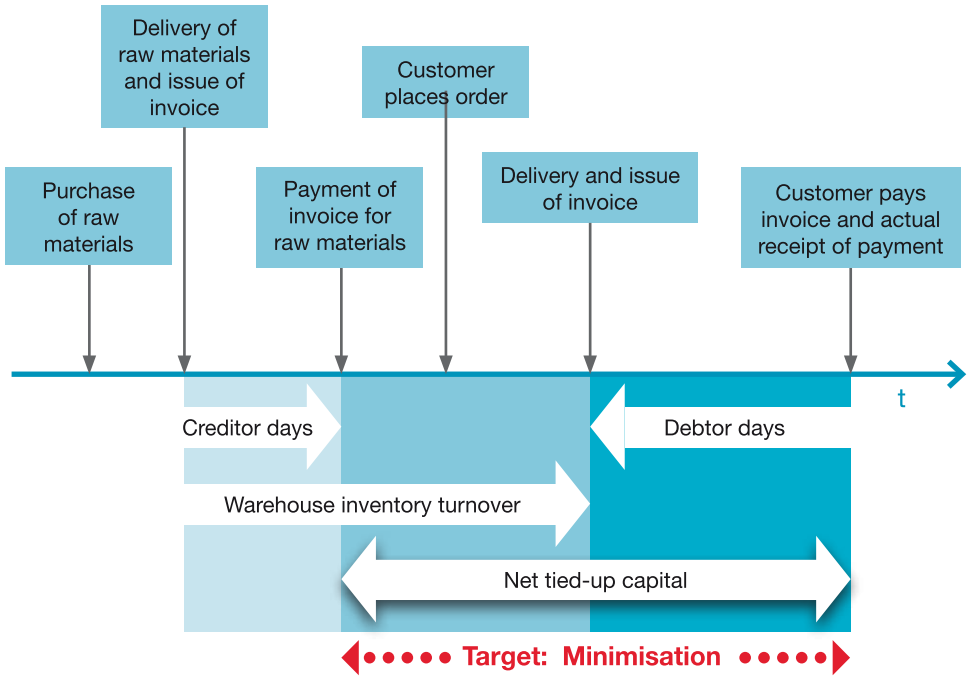
The processes in the CCC that occur between procurement and the settlement of the sales invoice can be optimised in various ways.

(1) An effort could be made to lengthen the period (i. e. days) in which creditors can pay (average trade payables in days). However, in this connection, the possible elimination of an early payment discount has to be weighed against the advantages of an interest-free trade credit.

(2) In addition, warehouse inventory turnover (average inventory in days) represents a major influencing factor for a company's tied-up capital. The shortening of production processes by so-called purchase on demand (only after the receipt of the order), or the setting up of consignment inventories (on the purchasing side) could be used with optimising effect. Here, the specific choice of measure will depend, to a large extent, on which industry is concerned.

(3) Ultimately, systematic receivables management is frequently of vital importance for companies. In connection with this, at least two factors should be taken into account. On the one hand, 6% of customer receivables, on average, turn into bad debts in Germany. Active debt recovery and the possible use of debt collection companies can reduce this percentage. On the other hand, you should bear in mind the payment terms that are granted to customers. The shorter the period between the invoice being issued and the payment being received, the smaller the amount of net capital that is tied-up and the sooner the financial resources are available to the company.

Recommendation: Overall, through active working capital management it is possible to achieve a noticeable impact on the accounts – in the form of a balance sheet contraction, or an increase in the equity-to-assets ratio. Typically, such measures increase a company's flexibility and lead to an improved negotiating position vis à vis financiers. The essential basis for active working capital management is a systematic analysis and optimisation of inventories. Here the objective is to identify, e. g. idle inventory and to reduce it systematically. We recommend that at least one key figure, at a time, for the development of receivables, inventories and payables is rolled out in the on-going controlling. In the course of this, target values should be set in order to ensure on-going optimisation



Cash-Conversion-Cycle (CCC)

of working capital. For support in this area please do not hesitate to contact your PKF consultant.

IN BRIEF

Non-deductibility of tax consulting fees – appeals have been rejected

The highest tax authorities of the *Länder* (Federal States), in an order of 25.3.2013, ruled that objections that were pending or permissible, or amendments against the non-deductibility of tax consulting fees as special expenses, that has been in force since 2006, had been rejected. For taxpayers affected by this decision of general application it is possible to take legal action. Furthermore, a Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) circular, of 25.4.2013, gave notification that, with immediate effect, no more preliminary tax notices shall be issued in respect of this point of law.

PKF Issues – NPO

Edition 1/2013 of the PKF Issues series on Non-Profit Organisations was recently published (available at www.pkf.de). It is devoted to the new provisions of the so-called Act to Strengthen the Voluntary Sector, that came into force on 29.3.2013, and of which some parts are applicable from 1.1.2013. For example, this applies to the increase in the tax-free allowances and the limits to (single purpose) non-profit organizations.

BONMOT ZUM SCHLUSS

"If individuals in a certain income bracket had to bear the full burden of tax law, without any tax privileges, they wouldn't be able to survive."

Franz Klein (*1929), former president of the BFH

Impressum

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