PKF

Accountants &
business advisers

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Editorial

Dear Readers,

Already in 2009, the G20 heads of state and government decided to make over-the-counter derivative trading more transparent and more secure. Then, last year, with a view to implementing these goals throughout the EU, the European Market Infrastructure Regulation (EMIR) came into force. This will have an impact on the financial structures of many small and medium sized enterprises, too. For that reason we take a closer look at the effects in the Focus section of this issue of the PKF newsletter.

At the end of June, as is well known, large sections of the original Annual Tax Act 2013, after many hold-ups, finally found their way into the German tax legislation (cf. short overview in issue 06/2013 p. 3). Thus, the possibilities of gifting or bequeathing in a tax-privileged way, within the scope of business assets and also financial assets, have been restricted – you can read more about this, subsequently, on p. 3. Following on from this is an article on VAT invoicing, another focus of the new legal provisions.

If you are planning to transfer business assets by gifting or bequeathing, we recommend that you read the last of our main articles. This is because, in individual cases, under circumstances that require closer analysis, it is possible to use various valuation methods in order to determine the amount of the taxable transfer. Frequently, it is possible to choose between, for example, the legally standardised simplified income method and a valuation based on the IDW S1 standard. As the current, very low interest rates tend to lead to an overvaluation with the simplified income method, in this respect, the use of an alternative method – as explained in detail on p. 7 – could be advisable.

Yours sincerely,
Your PKF Team

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FOCUS

European Market Infrastructure Regulation (EMIR) – Consequences for small and medium sized enterprises

The European Market Infrastructure Regulation (EMIR) provides greater supervision of so-called over-the-counter derivatives trading. The tighter monitoring will basically affect all companies that use derivatives, although non-financial companies that remain below a so-called clearing threshold, however, are less affected. Nevertheless, irrespective of this clearing threshold, considerable obligations in the area of risk management and reporting have to be observed. At the same time, many companies will also have to be scrutinised separately. Since violations risk fines of up to € 500,000, you should already be focusing on this issue now.

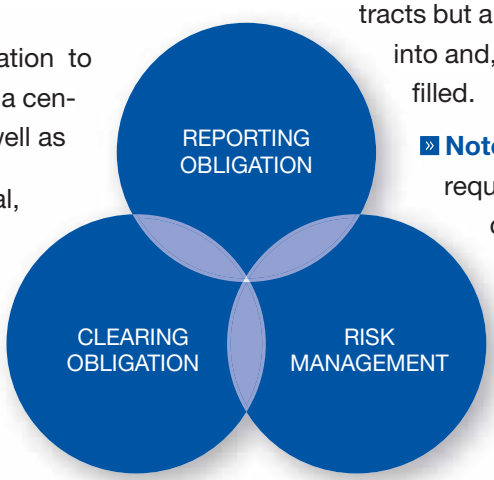
I. Clearing threshold

Only for the non-financial sector, there are two types of simplification linked to the clearing threshold, provided that the unfulfilled contracts do not exceed certain amounts. Thus

(1) the costly fulfilment of the obligation to "clear" derivative transactions through a central counterparty (clearing house), as well as

(2) the obligation to exchange collateral,

only apply to companies that have unfulfilled contracts in one derivate category (excluding hedging contracts and, if applicable, intragroup derivatives) with a gross nominal value of € 1 bn or € 3 bn.



II. Risk mitigation techniques

Even if the OTC derivative value falls below the clearing threshold, nevertheless, certain risk mitigation techniques, which aim to reduce counterparty risk, have to be applied to non-cleared derivatives:

- Since March 2013, OTC derivative transactions, including the terms of the trades, have been subject to a timely confirmation requirement, preferably in electronic form.
- From September 2013, the counterparties have to agree to perform regular portfolio reconciliations in order to identify any discrepancies, e. g. in the valuation of the derivatives.
- In September 2013, too, rules pertaining to portfolio compression and dispute resolution will also come into force.

III. Reporting and documentation obligation

With a view to making the derivatives market more transparent, EMIR includes the obligation to report all derivative contracts to a recognised trade repository. Originally, the first derivative contracts should have been reported from July 2013, however, due to delays in the approval of trade repositories, some market participants expect that the reporting obligation might possibly only apply from the beginning of 2014 on. Then, however, there will be a reporting requirement not only for all open derivative contracts but also for all those that have been entered into and, in the meanwhile, are no longer unfulfilled.

» **Note:** As the planned set of reporting requirements is quite extensive, smaller companies, in particular, should consider the possibility of delegating reporting obligations. In that case, the bank with which the derivative contract was concluded could perform the reporting.

IV. Auditing requirements

For financial years beginning after 16.2.2013, corporations and commercial partnerships with the same status, that are not financial counterparties, have to have their processes, that have been set up in relation to the compliance with the obligations arising out of EMIR, reviewed by a suitable auditor or a *vereidigte Buchprüfer* [licensed auditor in public practice authorised to perform only statutory audits of annual financial statements of mid-sized German limited liability companies (GmbH)]. An exemption to this applies to companies that

- are classified as small enterprises in accordance with the relevant criteria for the preparation of accounts, or
- in the preceding year, entered into OTC derivative transactions with an overall nominal value of up to € 100 m, or a maximum of 100 OTC derivative contracts (without taking into consideration intragroup transactions).

V. Recommendations

Even if, currently, some of the details with regard to the implementation of EMIR have yet to be clarified, you should check the extent to which your company will be impacted by EMIR. In view of the timely and, to some extent, retroactive application of the new rules, you should, moreover, already start implementing additional measures. These could include: collecting the corresponding data, preparing the IT systems, as well as obtaining a so-called Legal Entity Identifier from WM Datenservice (a global financial database).

» **More Information:** The *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin) [German Federal Financial Services Supervisory Authority] has additional information available on this topic at www.bafin.de/DE/Aufsicht/BoersenMaerkte/EMIR/emir_node.html (in German). You will also find further details in the current issue of the "PKF Issues – Family Businesses" series (at www.pkf.de, German only). For advice on the current status and optimal implementation, please do not hesitate to contact your PKF consultant.

TAX

Corporate Taxes

Stricter gift/inheritance tax rules concern not only the so-called "Cash GmbH"

» **Who for:** Taxpayers who (will) transfer or (will) receive business assets through gifting or through inheritance.

» **Issue:** Preferential treatment of business assets, in the case of legacies and gifts, depends on the portion of business assets that comprises so-called *Verwaltungsvermögen* (non-operating assets). With effect from 7.6.2013, the term *Verwaltungsvermögen* (non-operating assets) was broadened, to the disadvantage of taxpayers. Moreover, as of this date, there are tighter rules relating to so-called *junges Verwaltungsvermögen* (non-operating assets that have been held for a period of less than two years) that, in any case, remain excluded from the preferential tax treatment accorded to business assets. From now on

- cash and cash equivalents, cash at bank, pecuniary claims and other receivables, less debt shall be included in 'harmful' (i. e. having a detrimental effect from a tax point of view) non-operating assets, if the remaining balance exceeds 20 % of the stated value of the business assets.
- The remaining balance resulting from funds and receivables deposited and withdrawn within two years (deposit surplus) will be allocated to *junges Verwaltungsvermögen*.
- The *junges Verwaltungsvermögen* of a subsidiary company shall not be offset and shall be recorded at fair market value at the parent company as non-operating assets (even if because of liabilities etc. the value of the subsidiary company is 0 or negative).

» **Recommendation:** The amended rules exclude measures which, up to now, have ensured that financial assets could be gifted or bequeathed in a tax privileged way, e. g. by cloaking the assets in a German limited company in a so-called "Cash GmbH" (a business entity where cash is deposited). However, they also concern all other companies, too. Therefore, long before you transfer assets, you should review the possibilities with respect to preferential tax treatment of business assets under inheritance and gift tax and, if necessary, react accordingly with the appropriate structures.

New obligations with respect to invoicing

» **Who for:** Companies and business owners.

» **Issue:** The German Mutual Assistance Directive Implementation Act includes important amendments pertaining to VAT (cf. previous reports in issues 11/2012 and 06/2013). These concern, in particular, self-billed invoices, mandatory information requirements and new time limits. In this respect, the following is applicable as of 30.6.2013:

Self-billed invoices – If a recipient of goods or services issues self-billed invoices for the goods or services received, then the billing document has to include the designation *Gutschrift* (self-billed invoice). The use of different wording (in Germany) invalidates the claim for input tax deduction. In German, in commercial practice, Gutschrift can also mean credit note (e. g. refund of a previ-

ous sale) and for this reason the term may not be used with this meaning, otherwise the recipient, in principle, would be liable for the VAT charged.

Mandatory information requirements – Invoices for goods or services where the liability for the payment of VAT is reversed (so-called reverse charge procedure) have to include, precisely, the reference *Steuerschuldnerschaft des Leistungsempfängers* (tax liability incurred by recipient).

Time limits – In the case of intra-Community supply of goods and other services by a domestic (German) company to a foreign company (so-called B2B service), an invoice has to be issued by the 15th of the month following the one in which the goods were delivered or the service was rendered.

» **Recommendation:** If you receive a document where VAT is charged that mistakenly includes the designation *Gutschrift* (self-billed invoice) you have to object in order to avoid VAT disadvantages. For credit notes used in commercial practice, in future, you should put another innocuous term (e. g. *Korrekturbeleg* [correction voucher], *Stornorechnung* [reverse invoice]).

» **More Information:** Other amendments to VAT law relate to the invoicing of travel services, or fall within the scope of differential tax. If you need any advice or more details on this as well as on any of the above-mentioned points, please do not hesitate to contact your PKF office.

Personal Taxes

Taking flood damage into account – Procedural simplifications and recognition of expenses

» **Who for:** Taxpayers who suffered damage due to the flooding in June

» **Issue:** The floods in June led to considerable damages. With a view to mitigating the consequences, the finance ministers of the German federal states concerned have published special administrative guidelines.

Accordingly, simplifications with regard to procedures will initially be granted. Those who were directly and materially affected may submit an application, by 30.9.2013, for an adjustment to their advance payments of income tax and corporate tax as well as for a deferral of tax liabilities due on this date or that become due. During this period, the authorities also intend to waive enforcement measures concerning taxpayers who suffered from severe damages due to the flooding, as well as to dispense with penalties for late payment of taxes. Furthermore, the loss of tax records should not have any negative consequences for the taxpayers. In addition, there is the possibility of deducting the costs of replacing home contents and clothes, as an extraordinary burden against income tax. In principle, the costs to clear up flood damage to an owner-occupied house or flat are, likewise, eligible. Ultimately, extraordinary write-downs and the creation of provisions for the purchase of replacement business assets will also be permissible.

» **Recommendation:** Please do not hesitate to contact us so that we can support you with respect to making use of all the relevant relief and submitting a timely application.

» **More Information:** You can find the decrees issued by the German federal states on the websites of the respective ministries (e. g. for Brandenburg at www.mdf.brandenburg.de, for Bavaria at www.stmf.bayern.de). Another administrative directive on this topic was issued by the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) in its circular of 21.6.2013 (www.bundesfinanzministerium.de, German version only).

Cross-border taxation – Apportionment of remuneration

» **Who for:** Employees and their employers.

» **Issue:** If employees work in several countries and the right to tax is conferred on each country in which they work (cf. article about the preconditions in the 04/2013 issue) then the remuneration shall be apportioned. In principle, the apportionment is based on the working days as agreed upon in the contract. Salary components that are granted directly on the basis of an actual activity in Germany or a foreign country have to be allocated directly. These could be e. g. travel costs, overtime compensation, supplements for working on Sundays, public holidays and during the night shift, expatriation allowances, project-related results bonuses or providing accommodation at the foreign place of work.

In the case of performance-driven remuneration, relating to a period of time, granted retroactively, e. g. bonuses, the circumstances during the period of time for which the performance-driven remuneration was granted shall be relevant. If an employee is granted a

bonus for his/her work in a foreign state, the right to tax is conferred on the foreign state. This shall apply even if the payment is made at a point in time when the taxpayer is not working there anymore. If, during the period of time, the taxpayer worked in several states, there has to be an apportionment.

In the case of severance payment that an employee receives in the course of a provisional termination of his/her employment contract, the reason for the payment is what matters. If the compensation is granted to compensate the loss of employment and not as additional remuneration for the work previously carried out by the employee, then the right to tax is conferred on the employee's state of domicile on the date of the payment.

» **Recommendation:** Please note that with some countries (e. g. Switzerland and Austria) Germany has agreed different rules in memorandums of consultations. These have priority in individual cases.

ACCOUNTING

Special purpose entities in consolidated accounts

» **Who for:** Companies obliged to prepare consolidated accounts that encompass special purpose entities

» **Issue:** A parent company has to include in its consolidated accounts all enterprises over which it exercises a controlling influence. It does not necessarily have to have a shareholding under company law.

It is assumed that there is controlling influence on so-called special purpose entities. A special purpose entity exists if a parent company bears the majority of the opportunities and risks of another enterprise that pursues a narrowly prescribed and precisely defined target of the parent company. According to the preamble to the statute, based on international accounting standards in accordance with IFRS, the following indicators are applicable when determining whether or not a special purpose entity exists:

- the business operations are set up in favour of the needs of another enterprise.
- Another enterprise can obtain the majority of the benefits from the business operations.
- Another enterprise is exposed to the risks from the business operations.
- Another enterprise retains the majority of the risks from owning assets of the special purpose entity in order to obtain benefits for its own business operations.

For example, an enterprise that is set up expressly for the parent company, in order to provide the parent company with property, machinery etc. by means of full payout leases, is a special purpose entity. By contrast, a property company as part of an operational split shall not be regarded as a special purpose entity unless further preconditions are met. However, if the operating enterprise does indeed bear the risks associated with the financing of the assets that have been made available for use (e. g. loans, guarantees), it could be necessary to consolidate it into the group.

» **Recommendation:** A careful examination is required to determine whether or not the preconditions for a special purpose entity exist. It has to be taken into account here, that even minor changes in the circumstances (e. g. assuming a guarantee) can mean that a previously non-consolidated company can become a special purpose entity. The related effects on the presentation in the financial statements can be significant. Therefore, prior to such adjustments you should give some thought to this.

New standards for management reports

» **Who for:** Companies and groups that prepare a management report and/or a group management report.

» **Issue:** The professional standards for the preparation of management reports conform with, in particular, the statements of the Accounting Standards Committee of Germany (*Deutsches Rechnungslegungs Standards Committee*, DRSC). In a new version of these standards (DRS 20), that should be applicable for financial years from 2013 onwards, changes have been made that relate to the presentation of forecasts as well as the opportunities and risks of future developments:

(1) Previously, projections for, at least, two years were required; now, a one-year outlook will be sufficient. However, it is imperative to specify foreseeable events that could exert significant influence on the economic situation after the end of this period of time.

(2) Expressly required now is

- the use of qualifiers for comparative forecasts (e. g. "slight increase in profits"), or
- projections of points or ranges (e. g. "profit of € 110 m" or "profits of between € 105 m – € 115 m").

By contrast, forecasts that are purely qualitative or simply comparative (e. g. "satisfactory profits" or "rising profits") shall be considered to be inadmissible. If the company's forecasting ability is significantly impaired because of special macro-economic conditions or exceptional uncertainty, by way of exception, scenario analyses with comparative forecasts or a presentation of the general direction of developments would also be sufficient.

» **Recommendation:** It is recommended to base not only group management reports but also single company management reports on DRS 20. Given the multiple changes compared with the previous standards, the changeover to the new guidelines should be prepared carefully. The DRSC also recommends the application of these rules to the financial years prior to 2013. Please do not hesitate to contact a PKF consultant if you require further information or help.

LEGAL

Clauses which terminate pending contracts in the event of insolvency are unenforceable

» **Who for:** Companies with contracts that have not been completed yet.

» **Issue:** Many contracts contain clauses that result in the termination of the contract upon the insolvency of one of the parties. An energy supplier had thus agreed with its customer: "This Agreement shall automatically be terminated, even without notice, if the Customer files a petition for bankruptcy, or (...) if preliminary insolvency proceedings are initiated or opened". After the insolvency of the customer, a dispute arose as to whether or not this agreement was enforceable. The Federal Court of Justice (*Bundesgerichtshof*, BGH) recently ruled that such clauses are unenforceable if they relate to agreements for the supply of goods or energy. This deprives the insolvency administrator of the opportunity to implement an agreement that would be favourable for the debtor.

While the ruling of 15.11.2012 expressly deals with agreements for the supply of goods or energy, however, it could be applied to various other types of contracts. The ruling (for the time being) does not have any significance for contracts that have been fully implemented. Articles of association, according to the statement of justification, are also not covered. However, despite this, caution is required because the BGH, in principle, holds such clauses for contracts where part of a party's obligations have not yet been completed to be unenforceable. Therefore, it is to be expected that future rulings will establish that equivalent clauses in other contracts are also unenforceable.

» **Recommendation:** All contracts where part of a party's obligations have not yet been completed, which contain clauses that result in the termination of the contract upon the insolvency of one of the parties, should be reviewed and, if necessary, adjusted. Besides the BGH ruling, general principles should be observed and, in particular, the law pertaining to general terms and conditions.

» **More Information:** The full text of the BGH ruling of 15.11.2012 (case reference: IX ZR 169/11) is available at www.bundesgerichtshof.de (German version only).

Bonus payments made in reasonable discretion are permissible – more options for employers

» **Who for:** Employers and employees.

» **Issue:** The Federal Labour Court (*Bundesarbeitsgericht*, BAG) has given its view on the question of whether a clause in an employment contract in which the employer reserves the right to decide the amount of an annual bonus is permissible. In a recent case, a contract clause according to which an employee's annual Christmas bonus entitlement "amount was determined annually", by the employer, was viewed as being enforceable by the court.

The judges checked the admissibility according to the general terms and conditions of business. First of all, in the selected wording, they did not see an inadmissible right to make changes (Section 308 no. 4 of the German Civil Code), as it makes it possible for the employer to determine the amount of the benefit in the first place and not to adjust it subsequently. Nor was there an infringement of the transparency requirement (Section 307(1) sentence 2 of the German Civil Code), although the clause itself did not include any benchmarks for determining the bonus. This is due to the fact that the employer is not obliged to create a legal entitlement. He could prevent this by contractual reservation as to the voluntary nature

of the benefit.

Likewise, the court rejected the notion that the employee had been unreasonably disadvantaged (Section 307 (1) sentence 1 of the German Civil Code). Unilateral rights to determine performance are already generally legally recognised. Furthermore, no particular achievements, during the reference period, should be rewarded by the bonus.

» **Recommendation:** The ruling increases the possibilities for employers to make flexible arrangements for annual special payments. Employers may reserve the right to determine annual bonus payments at their reasonable discretion. The criteria for exercising discretion do not have to be mentioned here. However, the employees have the possibility to obtain a judicial review of how this was determined. In particular, when no special payment is made, circumstances that justify this, such as a decrease in profits, have to be present.

» **More Information:** The full text of the BAG ruling of 16.1.2013 (case reference: 10 AZR 26/12) is available at www.bundesarbeitsgericht.de (German version only).

CORPORATE FINANCE

Valuing a company for tax purposes – Significant differences in the values depending on the method

» **Who for:** Businesses that require a company valuation for tax purposes.

» **Issue:** When valuing a company for tax purposes, in many instances, the law provides for the possibility of choosing between different valuation methods. Frequently, there is the option of using a valuation prepared by an expert (e. g. in accordance with IDW S1), or one based on the legally standardised simplified income method. According to both IDW S1 and the simplified income method, the enterprise value is calculated as the sum of all discounted future earnings. The differences, however, are to be found in the details, in particular with respect to determining the future earnings and determining, or the level of, the discount rate.

(1) Future earnings – While according to IDW S 1, future earnings are, basically, derived from a business plan, with the simplified income method, in principle, recourse is made to average past results.

(2) There are further differences related to the **discount rate** this being the sum of the base rate and the risk premium. In accordance with IDW S 1, the **base rate**, for the respective valuation date, is derived from the future oriented yield curve for government bonds and adjusted by the personal tax charge. By contrast, with the simplified income method, over the course of one year, one base rate, as published by the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) is applicable to all the valuation dates. The risk premium according to the simplified income method is 4.5 %. By contrast, IDW S 1 stipulates a capital market orientation for the derivation of this item. To this end, the market risk premium, which according to the IDW recommendation is currently 5.0 – 6.0 % (cf. issue 02/2013), (after personal income tax) is multiplied by the so-called beta factor. The latter establishes comparability between the company to be valued and the overall market – a beta greater than 1 indicates that, compared with the overall market, a company's risk is higher, a beta less than 1 indicates that the risk is accordingly lower.

(3) Synopsis: In the following table, the components of the discount rate in accordance with IDW S 1 and the simplified income method, explained above, are compared in an overview based on the assumption of an average market risk (beta = 1.0). Here, the capitalisation factor is the inverse of the discount rate. It gives the value by which the future earnings have to be multiplied in order to calculate the enterprise value. For the comparison, it

Year	Base rate		Capitalisation factor			
	IDW S 1*	German Valuation Act	IDW S 1*	German Valuation Act	Difference	in %
2008	3.50 %	4.58 %	12.50	11.01	-1.5	-11.9 %
2009	3.13 %	3.61 %	13.11	12.33	-0.8	-5.9 %
2010	3.13 %	3.98 %	13.11	11.79	-1.3	-10.0 %
2011	2.39 %	3.43 %	14.51	12.61	-1.9	-13.1 %
2012	2.02 %	2.44 %	13.29	14.41	1.1	8.4 %
2013	1.66 %	2.04 %	13.97	15.29	1.3	9.4 %

Table 1. A comparison of the results of the valuation methods
* In each case as of 1.1. or 30.6.2013; after personal taxes

was assumed that the future earnings in the application of IDW S 1 or the simplified income method were at the same level and, in each case, constant.

» **Recommendation:** In order to estimate the differences in value, and possibly make use of them, the following approach is advisable – If the simplified income method may be used for the purpose of tax valuations, it is recommend, in the case of valuations for tax purposes, to perform, additionally, a rough valuation using a different possible method (e.g. IDW S1). If, in the course of this, indications emerge that the outcome of the alternative to the simplified income method is likely to be more favourable, a precise calculation should be considered.

IN BRIEF

New E-tax balance sheet taxonomy for 2014

On 27.6.2013, the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) published an updated taxonomy. The application of this should be mandatory for financial years beginning after 31.12.2013. However, earlier application will not be subject to complaint. The new presentation structure is available online at www.esteuer.de (German version only).

PKF Issues – Public Sector series

A new edition of the "Public Sector" Issues series was recently published and is available for download at www.pkf.de (German version only). The new issue discusses, among other things, the current need for action with respect to consolidated tax groups. Furthermore it focuses on specific sector topics, for example, from the transport and utility industries.

AND FINALLY…

"That's the beauty of accounts, that losses can be disguised as profits and profits can be masked as losses."

Peter E. Schumacher (* 1941), Publicist and Collector of Aphorisms

Impressum

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