PKF
Accountants &
business advisers

PKF newsletter 09|13

Editorial

Dear Readers,

The final phase of the current legislative period is indeed characterised by a calming down in legislative activity in many areas. However, that does not leave much room for relaxation, as significant changes in case law require intense consideration. Therefore, the Focus section of this issue deals with a series of recent Federal Fiscal Court (*Bundesfinanzhof*, BFH) rulings on company car taxation that hold in store for you both positive aspects but also a number of drawbacks.

In the Tax sections, besides further BFH rulings (such as on the deduction of anticipation outlays in the case of a failed acquisition) and changes to guidelines (e. g. scope in the valuation of employee discounts), as in earlier issues, we discuss specific aspects of cross-border employee taxation. The article on p. 3, about the transfer of employees within a group, is the last one in our series. We would particularly like to draw your attention to the article about the extended offsetting of old speculation losses which is still possible up to the end of 2013. If this applies to losses your business incurred and you intend to offset these losses there is need for short-term action.

With regard to legal matters, special attention should also be paid to a recent Federal Court of Justice (*Bundesgerichtshof*, BGH) ruling in connection with crises at group companies. In the ruling, the Court has refused de facto to accept the sale of assets in exchange for assuming liabilities owed to the shareholders of a company in crisis. Therefore, both previous as well as planned restructuring efforts in groups of companies should be reviewed with respect to the liability risks that can arise as a result.

We hope that this time, too, we have presented some useful approaches for resolving issues in both your business life and your private life.

Yours sincerely,
Your PKF Team

Contents

FOCUS

New rules for the taxation of company cars

Recently, the Federal Fiscal Court (*Bundesfinanzhof*, BFH) issued a series of new rulings on the taxation of company cars. In these, the BFH, first of all, ruled in favour of the employees by clearly rejecting across-the-board taxation of company cars. At the same time, however, the judges also changed their view on the application of the 1% rule in cases where vehicles are provided for the employees. Now, the provision of a company car for private use can also result in this being treated as remuneration even if there is actually no such private use.

I. Basic regulations

If employees are provided with a company car, free of charge, or at a discount, for private use, too, this results in a taxable, non-cash benefit for the employee. The benefit is valued either by means of a driver's log book, or if no proper driver's log book is kept, at 1% of the gross list price per month (1% rule). Here, the benefit from the provision for use covers both making the vehicle itself available as well as the assumption of all costs related to it.

II. Private use is not generally presumed

In different rulings from 21.3.2013 and from 18.4.2013, the BFH clarified that company car taxation only applies if the employer has actually provided the employee with a company car for private use on the basis of a usage agreement as part of an employment contract, or at least, on the basis of of an implied agreement. If it is not clear that the employee may use the company car privately there is no prima facie evidence that an actual possibility for private use exists. Thus

Company car as a non-cash employee perk

- there should not be a blanket assumption that a company car that has been provided for an employee by an employer is also available for private purposes,
- nor should it be assumed that the employee is making unauthorised private use of a company car that has been provided for business purposes. This even applies if the employer does not monitor a ban on private use that has been agreed in an employment contract.

» **Recommendation:** Under employment law, in order for an employee to be authorised to use a company car privately as well, a corresponding agreement is necessary. Without any further arrangements, the employee may only use the company car for business trips. To clarify the issue, the employment contract should, for example, document not only the permission for, but also if applicable, the ban on the private use.

III. The possibility of private use is also deemed to be enrichment even if no actual use is made

According to a BFH ruling from 21.3.2013, the provision of a company car to an employee for his/her private use, irrespective of the actual circumstances of the usage, is deemed to be an enrichment of the employee. What matters is just having the possibility to use the company car privately as well. Thus, in contrast to the previous assumption made in the rulings, it is not particularly relevant with regard to the tax assessment whether or not the *prima facie* evidence of actual private use can be challenged (for example, by providing proof of actual use solely for business).

By way of derogation from this, in the area of operating income (for example, in the case of a sole trader), providing proof that a company car is actually used solely for business still means that taxation according to the driver's log book method, or the 1% rule is avoided.

» **Recommendation:** In order to avoid burdening the employee with taxes as well as avoiding payroll tax risks for the employer there is a need for action in all cases where the employee is allowed to use a vehicle privately but does not actually exercise this

right. Here, for example, an employer can withdraw his authorisation for private use, or the employee can waive the right of use that has been granted.

» **More Information:** The BFH rulings, which have been mentioned, from 21.3.2013 (case references: VI R 31/10, VI R 42/12; VI R 46/11) as well as from 18.4.2013 (case reference: VI R 23/12) can be found at www.bundesfinanzhof.de (German versions only).

TAX

Corporate/Personal Taxes

Deduction of futile expenses in the case of a failed acquisition of a shareholding

» **Who for:** Corporations that had to pay due diligence costs.

» **Issue:** A German *Aktiengesellschaft* (joint stock company, D-AG) intended to acquire shares in a Swiss AG. In the course of the acquisition process, a due diligence was carried out and, based on the result of this, the acquisition ultimately failed. In its decision of 9.1.2013, the Federal Fiscal Court (*Bundesfinanzhof*, BFH) ruled in favour of the D-AG that, for this type of expenses, the prohibition on deduction in accordance with Section 8b (3) of the German Corporation Tax Act (as amended in 2002) does not apply.

The BFH was of the opinion that only reductions in profit incurred in connection with shares actually held in a corporation were subject to the prohibition on deduction, on condition that the interests held in a corporation are attributable to the taxpayer concerned, under civil law or from an economic perspective. However, if the intended acquisition of a shareholding does not actually take place, then the futile expenses thus represent deductible business expenses. Generally,

- as soon as the basic decision to acquire has been made, up-front costs of the acquisition process (e.g. due diligence costs, feasibility studies, developing business plans), in the case of a successful outcome, represent the ancillary costs of the acquisition of a shareholding in the company.
- Costs incurred before the decision can be deducted as business expenses.

» **Recommendation:** In order to be able to differentiate the expenses that are immediately deductible, the date of the decision should be documented accordingly (shareholders' resolution, minutes of meetings, etc.).

» **More Information:** The BFH ruling of 9.1.2013 (case reference: I R 72/11) is available at www.bundesfinanzhof.de (German version only).

The transfer of employees within a group – Who is the employer?

» **Who for:** Employees who have been transferred and their employers.

» **Issue:** An employee transfer within a group is deemed to have taken place if an employee agrees with his/her (German) domestic employer to work, for a limited period of time, at an associated company in a foreign country. What matters with respect to taxation is which company is deemed to be the employer.

- If the (German) domestic company, making the transfer, remains the employer, then the employee's country of residence could possibly be entitled to tax, subject to the 183-day rule (cf. PKF Newsletter 04/2013).
- If the foreign hosting company is the employer, then the right to tax is conferred solely on the country in which the employee works.

The employer, in the aforementioned sense, is deemed to be whoever concludes an agreement, under employment law, with the employee, or integrates the employee into a business activity, is authorised to give the employee instructions and bears, or should have borne, financial responsibility for the remuneration from employment paid to the employee (the so-called economic employer). With regard to the question of who should have borne financial responsibility for the remuneration, you have to take into account whose business interests are being served by the transfer and whether or not the managing director of an independent company would have borne the same amount of expenses for a comparable employee. Which company pays out the remuneration to the employee is not relevant.

In the event of a transfer of up to three months, a rebuttable assumption is made that the company making the transfer remains the economic employer.

» **Recommendation:** This guidance corresponds to the view of the German tax authorities. In the event of a trans-

fer, the consequences for employees and employers, but also the view of the foreign state, should be checked in advance. Please do not hesitate to contact your PKF consultant if you require any support. If required, help is also available through the PKF international network.

» **More Information:** A BMF circular, of 9.11.2001, (German Federal Tax Gazette, *Bundessteuerblatt*, BStBl. II 2001 p. 796) contains further details about the relevant opinions of the German tax authorities (German version only).

Personal Taxes

Employee discounts – BMF grants greater scope for valuation

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

» **Issue:** If an employee receives income in the form of non-monetary benefits (so-called benefits in kind) these have to be valued within the scope of payroll taxation. Here, two valuation methods may be taken into consideration:

(1) Valuation at the final price of the drop-off location, adjusted by the usual discounts. The final price in this sense is also the most favourable price identified in the market; for this, the evaluator can include publicly available internet offers.

(2) Valuation according to the discount scheme. For staff purchases by employees, a valuation adjustment of 4 % and an additional annual tax-free allowance for discounts of € 1,080 are applicable. The basis for this is not the most favourable price in the market but the amount, on average, at which the employer offers the goods or services to his customers in general business transactions.

Last year the Federal Fiscal Court (*Bundesfinanzhof*, BFH) confirmed its respective rulings according to which employees may select the valuation method that is most favourable for them. The tax authorities have now adopted this new view. For both the payroll withholding tax method as well as for the assessment procedure for the *employee*, the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) accepts the right to select between both alternatives.

The *employer* is not obliged to apply the valuation under alternative (1). If he nevertheless bases his valuation on the discount scheme in the assessment procedure, the employee is able to identify a more favourable market price and adjust the previously taxed remuneration.

» **Recommendation:** As an employer has to keep a record of the basis for the final price that is used to calculate payroll tax, to document it and to provide simple notification of this to an employee, upon request, a guideline should be set out in writing, accordingly, for the personnel department.

» **More Information:** The BMF circular of 16.05.2013 can be downloaded at www.bundesfinanzministerium.de (German version only). The previous BFH rulings of 26.7.2012 (case references: VI R 30/09 and VI R 27/11) are available at www.bundesfinanzhof.de (German version only).

Extended offsetting of old speculation losses now only possible to a limited extent

» **Who for:** Taxpayers who still have tax loss carry-forwards from speculative transactions from before 2009.

» **Issue:** With the introduction of withholding tax, the possibilities for offsetting losses against income from capital assets and private disposal gains changed and became limited. This includes the offsetting of tax-effective losses from the sale of securities and property acquired before 1.1.2009. The offsetting of such losses against positive income can be done...

- **...for an unlimited period of time** with gains from private disposals, e. g. from the sale, within 10 years, of private properties, of foreign currencies, of precious metals, or the sale of works of art within a one-year speculative period and to the extent that the tax exemption limit of € 600 has been exceeded;
- **...only until 31.12.2013** with disposal or redemption gains from capital assets (e. g. shares, fixed income securities).

Therefore, the current year provides the last opportunity to offset old existing speculation losses against disposal gains from capital assets.

» **Recommendation:** Use can be made of the extended offsetting possibilities, available until the end of 2013, through targeted measures, such as, e. g. the realisation of capital gains in securities acquired after 31.12.2008, or limiting the offsetting of losses within a portfolio during the course of the year. You should contact your financial advisor and request an individual strategy for using

up loss carry-forwards. Please do not hesitate to contact your PKF consultant for any other questions, or if you would like the strategy to be reviewed.

ACCOUNTING

Accounting treatment of interest on tax refunds and on tax arrears – the economic perspective is key!

» **Who for:** Companies and business owners obliged to prepare accounts.

» **Issue:** Receivables can only be capitalised if they have come into legal existence during the reporting period. The right to interest on a tax refund, from a legal point of view, comes into existence when a tax assessment has been completed. In the opinion of the tax authorities, it is in accordance with the latest Federal Fiscal Court (*Bundesfinanzhof*, BFH) ruling to take into account the economic perspective. Thus, the receivable should be capitalised, at the earliest, on the reporting date that is 15 months after the end of the calendar year in which the tax refund claim arose. Although, the receivable only covers the interest that has arisen, from an economic point of view, up to the reporting date. The precondition is that, on this date, there should be no legal obstacles, neither substantive nor procedural, to the realisation of the claim.

Furthermore, a provision for the obligation to pay interest on account of tax arrears that have arisen basically implies that a sufficiently substantiated obligation in the form of a tax assessment exists. By contrast, a provision for interest on tax arrears should be created, at the earliest, 15 months after the end of the calendar year in which the tax arrears claim arose. Although, here too, the provision should only cover the interest that has arisen, from an economic point of view, up to the reporting date.

» **More Information:** In its decision of 22.4.2013, the Frankfurt/Main regional tax office (*Oberfinanzdirektion*, OFD) explaied the guidelines against the background of a BFH decision of 31.8.2011 (case reference: X R 19/10) which can be downloaded at www.bundesfinanzhof.de (German version only). We would be happy to provide you with the OFD decision, upon request.

Distinguishing between maintenance costs and construction costs for buildings presented in the financial balance sheet

» **Who for:** Companies who present residential or commercial properties in their financial accounts.

» **Issue:** In the case of buildings, construction costs that have to be capitalised arise through construction of, extension to or substantial improvements in a property over and beyond its original state. In order to differentiate these costs from maintenance costs that are recognised immediately as an expense, the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer*, IDW) has proposed the following distinctions:

(1) The **construction** of a building is deemed to have taken place if, among other things, after complete dilapidation, from a technical point of view, parts of a building that can still be used are salvaged and through building works a new building is constructed, or if after complete dilapidation from an economic point of view, parts of the building that determine its useful life are replaced.

(2) The **extension** of a building requires an increase in the substance of the building. This is the case, e. g. if components that were not previously part of the building are subsequently installed (e. g. installation of an alarm system, a lift, or a balcony). By contrast, if facilities that can be used on a stand-alone basis are set up then these are not deemed to be extensions. These should be treated as self-contained assets and depreciated according to their own useful life. An example of this is the installation of a combined heat and power plant that serves several buildings.

(3) If, as a result of building measures, the quality of a building is enhanced in at least three of the five key areas of fixtures and fittings (heating, sanitary facilities, electrical installation/IT, windows and heat insulation), it may be assumed that **substantial improvements to the building** have been made. The cost of building measures incurred shortly after the acquisition of a building represent acquisition related construction costs (that have to be capitalised) if the above-mentioned criteria are applicable. However, the IDW has rejected the notion that, in the financial accounts, expenses in excess of 15 % of the original acquisition cost should be capitalised within three years after the purchase, even though this is mandatory in the tax accounts.

» **Recommendation:** In the financial accounts, in contrast to the tax accounts, component-by-component,

scheduled depreciation of fixed assets is permissible. In the case of a building, e.g. the roof could be depreciated over a useful life of 20 years and the rest of the building over a useful life of 60 years. If, for example, the roof is then renewed, as a partial addition to the essential physical substance this gives rise to subsequent building acquisition or construction costs even if there has been no extension or substantial improvement.

» **More Information:** The draft, under discussion, for a new IDW standard (IDW ERS IFA 1) can be found at www.idw.de under "Verlautbarungen" (pronouncements).

LEGAL

Threat of piercing the corporate veil in the case of asset transfers in a group

» **Who for:** Affiliated group companies.

» **Issue:** A German limited company (GmbH) in crisis sold machines to an affiliated GmbH. However, by way of consideration given in exchange the affiliated GmbH did not make a purchase price payment but assumed corresponding debts from the crisis GmbH which were owed to the joint parent company. When, later, the GmbH in crisis went into insolvency, the insolvency administrator asked for the purchase price for the machines to be paid by the sister company or the parent company.

And rightly so, as the Federal Court of Justice (*Bundesgerichtshof*, BGH) recently ruled. In contrast to the lower courts, the BGH acknowledged a piercing of the corporate veil in accordance with the principles of the so-called liability arising from a withdrawal that destroys the economic basis of a company (*Existenzvernichtungshaftung*). As the parent company's claim would have been subordinated in insolvency proceedings, the assumption of this debt does not represent an adequate consideration given in exchange for the transfer of the machines. It was, thus, a case of unauthorised intervention, without compensation, in a company's assets. Furthermore, the BGH clarified that, therefore, the shareholder does not need to show intent to damage the company or its creditors. Instead, it is sufficient if the facts that lead to an unconscionable result are known to him/her and are condoned. This is not altered by the fact that the measure should actually have served the restructuring of the crisis GmbH.

» **Recommendation:** Particular caution is required if shareholder claims are to be used as a means of payment as they do not represent a fair market equivalent value on account of their subordination in insolvency proceedings.

» **More Information:** The full text of the BGH ruling of 21.2.2013, as discussed here, (case reference.: IX ZR 52/10) is available at www.bundesgerichtshof.de (German version only).

Exclusion clauses in employment contracts do not cover all claims

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

» **Issue:** Employment contracts frequently include contractual exclusion clauses that provide for the forfeiture of mutual claims if they are not asserted within a certain period of time. According to case law, the deadline has to be at least three months.

However, such clauses do not cover all possible claims arising out of the employment relationship. In particular, it is not possible to limit, in advance, the liability for intentional wrongdoing. The Federal Labour Court (*Bundesarbeitsgericht*, BAG), in its ruling of 20.6.2013, confirmed this once again and, therefore, ruled in favour of an employee who, after the end of the contractual exclusion period, had sued her employer to recover damages arising from workplace bullying.

Even if a clause in the employment contract does not limit claims that have lapsed, according to the court, the application of such clauses, on a regular basis, to cases that are already regulated by statute is not desirable. Furthermore, an exclusion clause in an employment contract that covers liability for intentional wrongdoing, in any case, would be invalid.

» **Recommendation:** In view of the unambiguous legal position, it is recommended that a contractual agreement should already incorporate a provision to the effect that the exclusion period does not apply to claims based on wilful conduct. Likewise, as a precaution, the exclusion provision should be set out in a section on its own with a separate heading (and not "buried" somewhere in the concluding provisions) to avoid a reproach for inserting a "surprise clause".

» **More Information:** A press release on the BAG ruling of 20.6.2013 (case reference: 8 AZR 280/12) was publis-

hed on www.bundesarbeitsgericht.de (No. 42/13, (German version only).

CORPORATE FINANCE

Practical issues with respect to the preparation of a financial plan

» **Who for:** All types of businesses.

» **Issue:** A financial plan shows the monetary consequences, in figures, of future business practices. In contrast to backward-looking financial ratios, a financial plan makes it possible to derive earnings potential and provides information for management and investors about the expected financial strength and, possibly, allows potential undesirable developments to be identified in advance. As a rule, it includes a company-specific presentation, broken down into business segments, of the expected financial position, cash flows and results of operations, which is supplemented by key performance indicators for corporate management. A financial plan is usually developed on the basis of actual figures, for the last one or two reporting periods, by those heading up each business segment (bottom-up), directly by the management (top-down), or in a two-way process. The planning horizon is usually two to five years.

A financial plan is deemed to be an essential instrument of good business management. Important objectives include:

- the visualisation of the operational and strategic planning of the business, or the group of companies,
- active risk management,
- data provision for capital providers, or for corporate transactions,
- forward-looking plausibility reviews in conjunction with the annual financial statement.

Experience from common practice in companies has shown that there are four key factors for the development of meaningful financial plans. There has to be a coherent planning model, the development of the plan has to be suitably organised and there has to a flexible operation of the planning model as well as an appropriate software tool for the implementation.

(1) Planning model – In order to further all the above-mentioned objectives to the same extent, the underlying planning model itself has to be coherent and meaningful. This implies that the cause-and-effect links between the parameters that are to be forecast (income and expense as well as assets and debts) are correctly derived from the business model (e.g. production-to-stock versus production-to-order, taking into account one-off effects, or seasonal influences). For the operational results, such links can be, frequently, relatively easily developed based on a sales forecast.

(2) Organising the development of the plan – By contrast, plausible planning of non-operating expenses (e.g. marketing, or other administrative expenses), or of the financial position and cash flows, requires detailed knowledge of the underlying business processes (e.g. the payment history of customers, the development of credit exposures) and special factors (e.g. upcoming restructuring measures). Consequently, in the case of complex business structures, in particular, a plausible financial plan can only be prepared in close consultation between the operational heads and a company's central departments (e.g. controlling department). Here, an integrated model consisting of mutually compatible presentations of the financial position, cash flows and the results of operations is indispensable in order to be able to draw meaningful and accurate conclusions.

(3) Flexible operation – A further requirement of the planning model is its flexible operation in order to be able to map complex business models and causal relationships, too.

(4) Choice of software – Linked to this is the selection of the planning tool that will be used. In principle, the possible choices include standard software (e.g. general spreadsheet programs), or specialist planning programs that, to a certain extent, also have access to data from other (partial) programs. With the latter systems, frequently, integrated planning has already been set up, nevertheless, the planning parameters can, usually be individually customised, taking into account the plausibility checks in the system. Consistent planning is, thus, made easier. However, these advantages often come at a very high price for the software and expenses, which should not be underestimated, for training the users. By contrast, the use of a conventional spreadsheet gives flexibilty in structuring and, as a rule, does not generate any additional costs. However, for complex models, in particular, this option harbours high error potential.

» **Recommendation:** The preparation of a meaningful financial plan can be a difficult endeavour even for smal-

ler businesses. The integration of different business functions requires close coordination of all those involved and tight project management. Therefore, support in the preparation, or in the review of a planning model, provided by a trained expert can be very helpful.

IN BRIEF

PKF Issues – Real Estate

A new edition of the „Real Estate" Issues series was published at the beginning of September and is available for download at www.pkf.de (German version only). Issue 2/13 focuses, in particular, on the new capital investment statute book and also addresses the fundamental changes in accounting standards under investment law. Other topics are the RETT-Blocker model (structures aimed at avoiding German Real Estate Transfer Tax) as well as the distinction between real estate assets and operating facilities, which is of significance for many types of tax.

Lower administrative fines for disclosure violations

In a resolution from 28.6.2013, the *Bundestag* (lower house of German parliament) reduced the level of administrative fines for disclosure violations. In future, the minimum fine for small businesses shall be just € 1,000, instead of € 2,500, and for micro-enterprises just € 500. As previously, after being warned about the administrative fine, all businesses will still be given six weeks to make the disclosure before the administrative fine is imposed.

AND FINALLY…

"A tax increase is the government's revenge for us having elected them."

Erhard Blanck (*1942), German non-medical practitioner, author and painter

Impressum

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