PKF

Accountants &
business advisers

PKF newsletter 10|13

Editorial

Dear Readers,

The changeover to the so-called SEPA scheme for payment transactions, as of 1.2.2014, is getting closer. This represents the most far-reaching change in payment transactions since the introduction of the Euro. The Focus section of this issue of the PKF Newsletter discusses what action needs to be taken and points out the obligations and risks associated with the new scheme for your company.

After much toing and froing, the definitive BMF circular on the Entry Certificate has now finally been issued. The original rules have been relaxed for the benefit of the taxpayers. In the PKF Latest News, which accompanies this PKF Newsletter, you can read how, in the future, you can provide unambiguous proof of intra-Community supplies. With respect to the application of the new rules, the authorities have granted a transitional period, which we discuss on p. 7.

Unfortunately for freelancers, we have to report on an unfavourable development with respect to VAT. A new Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) circular has severely restricted the possibility of paying VAT on the basis of actual cash receipts - you can read more on this on p. 3.

With the year-end not all that far off, for many companies, the reporting date is getting closer and initial preparatory work for the annual financial statement is getting underway. Things that you need to pay attention to, as a borrower, with respect to the accounting treatment of processing fees have been summarised for you by us on p. 5.

We hope that with this as well as the other articles we have put together an interesting range of topics.

Yours sincerely,

Your PKF Team

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FOCUS

SEPA changeover - Risks, need for action and obligations of the company managemen

As of 1.2.2014, credit transfers and direct debits within the European Economic Area may only be processed in the so-called SEPA format. The extent to which this entails risks and a need for action by your company depends, among other things, on both the sector and corporate structure. However, a late changeover to the new payment systems not only harbours the threat of liquidity problems arising from delays in incoming payments but as well carries further risks, too.

I. Risks for a company

A flawed or delayed SEPA changeover (SEPA = Single Euro Payments Area) can cause a severe liquidity squeeze in your company if incoming payments are late. Conversely, however, delays in outgoing payments on your part, too, could lead to problems for the recipients of the payments (for example, employees, suppliers etc.), which could trigger reactions that are detrimental to your company. Generally, it is, thus, very important for your company to complete the changeover to the new payment modalities successfully by the above-mentioned date.

II. Changeover measures in the company

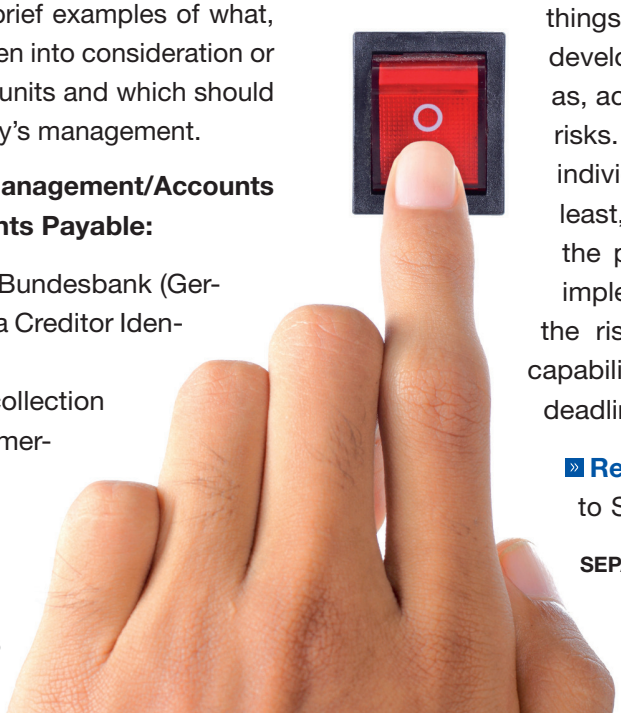
The changeover of business payment transaction processes to the SEPA format can be very time-consuming. Below is a list with brief examples of what, potentially, needs to be taken into consideration or done by various corporate units and which should be monitored by a company's management.

- **Accounting/Liquidity Management/Accounts Receivable and Accounts Payable:**
  - Apply to the Deutsche Bundesbank (German Federal Bank) for a Creditor Identification Number.
  - Set up a (direct debit) collection agreement with a commercial bank
  - Transfer previous authorisations for direct debits/standing orders into SEPA mandates
  - Satisfy the debtor pre-information requirements of the recipients of payments
  - Update bank details (IBAN/BIC) of suppliers/ service providers
  - Make arrangements for reverse entries and make adjustments to the debt recovery process
- **HR Department:** convert employees' account data; request IBANs
- **Legal Department/Contract Administration/IT/ Marketing:**
  - Adapt the General Terms and Conditions and the Impressum (a legally mandated statement of the ownership and authorship of a document, which has to be included in books, newspapers, magazines and websites published in Germany) as well as commercial documents
  - Adapt processes and, accordingly, the payment transaction software
- **Hotline/customer service:** prepare for customer enquiries about payment modalities.

III. Additional obligations of the company management

Insofar as a company prepares a management report, in it the company's managers, among other things, have to evaluate and explain the developments that are expected as well as, accordingly, the main opportunities and risks. In this connection, depending on the individual case, it could be necessary or, at least, helpful to include statements about the planned, or already completed SEPA implementation process, too and/or about the risks that would be entailed if SEPA capability is not achieved by the prescribed deadline.

» **Recommendation:** For the changeover to SEPA requirements, you should build a



SEPA - the switchover happens on 1.2.2014.

sufficient buffer into your time schedule in order to be able to carry out adequate testing, for example, of IT systems and payment transaction processes and also, if necessary, to be able to remedy any shortcomings. At the same time, within this scope, the switchover is also an opportunity to re-think all the processes and IT-based payment transaction procedures and, possibly, to establish more efficient payment processes.

» **More Information:** For more information about the SEPA scheme and the resulting changes in payment transactions please refer to the PKF Issues - Family Businesses series, which is available online at www.pkf.de (German version only).

TAX

Corporate/Personal Taxes

Is it possible to avoid double taxation on special payments to foreign shareholders

» **Who for:** Shareholders who live outside of Germany and who receive special payments from their German commercial partnerships..

» **Issue:** If a shareholder in a commercial partnership receives, e.g. interest, remuneration, etc. from "his/her" partnership then, from a German point of view, these special payments are taxable as part of the partnership's trading profits. If the company and the shareholder are residents of different states, the law then specifies that, under the terms of tax treaties, these special payments should also be treated as "business profits".

However, in 2010, the Federal Fiscal Court (Bundesfinanzhof, BFH) already ruled that this regulation was not sufficient to ensure that the payments were taxed in Germany, as the law did not regulate the necessary allocation to a permanent establishment. Nevertheless, the German government has reacted and now allocates the payments to the partnership's permanent establishment to which the expenses for the service underlying the remuneration have been allocated. As a consequence, in many cases, income tax, or corporate tax (plus, in each case, the solidarity surcharge) will be levied on the special payments to foreign shareholders. Moreover, trade tax will be levied on the special payments at the partnership level.

Many foreign states do not treat the special payments as trading profit. From the point of view of the foreign state, it is then a case of, e.g. interest payments, which according to a DTA, as a rule, may be taxed in the recipient's country of residence.

» **Recommendation:** Insofar as the payments are also taxed outside of Germany, double taxation occurs. How the economic consequences of this double taxation can be eliminated/abated has to be clarified in each individual case. Moreover, the text of the statute prescribes the application of the new regulation in all open cases. The extent to which the related retroactive effect is permissible appears to be questionable. Therefore, you should consider taking action against assessment notices for the period up to 2012. For more details please do not hesitate to contact your consultant.

» **More Information:** The BFH ruling, mentioned above, on the text of the old statute is from 8.9.2010 (case reference: I R 74/09). You can find it at www.bundesfinanzhof.de in the section "Entscheidungen online" (German version only).

Freelancers have to take into account the restrictions on VAT calculated on the basis of actual cash receipts

» **Who for:** Freelancers who keep accounts either because of statutory obligations, or voluntarily.

» **Issue:** Upon application to the local tax office, a business owner (insofar as s/he generates sales from working as a member of a liberal profession) may be permitted to calculate value added tax not according to agreed receipts (i.e. based on transactions that have been executed) but on actual cash receipts.

However, according to the Federal Fiscal Court (Bundesfinanzhof, BFH) ruling, if freelancers keep accounts they are obliged to calculate value added tax on the basis of agreed receipts. In this respect it is relevant whether or not accounts are kept because of statutory obligations, or voluntarily. As the constitutional complaint challenging this ruling was accepted for adjudication, the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) has now adopted the BFH ruling and decreed that permission to calculate VAT based on actual cash receipts may no longer be granted. Subject to the revocation of permission granted for VAT on the basis of actual cash receipts, transactions exe-

cuted after the 31.12.2013 will be impacted.

A revocation of permission may be dispensed with if, in calendar year 2012, overall sales generated by the business owner did not exceed € 500,000 and, therefore, permission for VAT on the basis of actual cash receipts could still have been granted.

» **Recommendation:** Insofar as you have to expect a revocation, depending on, among other things, your days accounts receivables, this could entail a significant drain on liquidity. If applicable, you should already start thinking now about how to cover your financial needs accordingly.

» **More Information:** The relevant BMF circular is from 31.7.2013 and is available at www.bundesfinanzministerium.de (German version only). The preceding BFH ruling of 22.7.2010 (case reference: V R 4/09) is available at www.bundesfinanzhof.de (German version only).

Personal Taxes

Holiday homes which are partly rented out and partly used by the owner - Income forecast required

» **Who for:** Taxpayers who rent out their holiday home but also, occasionally, use it themselves.

» **Issue:** In cases where a holiday home is, at times, used by the owner and, at times, rented out, over and over again, there are disputes about the extent to which the taxpayer actually intends to generate income from letting out the property. This aspect is crucial because, among other things, losses from letting out property may be offset against tax only if the intention to generate income has been established.

As the Federal Fiscal Court (Bundesfinanzhof, BFH) confirmed in a recent ruling, there has to be an examination of whether or not an intention to generate income exists and, in order to evaluate whether or not, in the long term, income will exceed the costs related to letting out the property, the taxpayer has to provide a forecast. In this, the costs related to letting out the property have to be allocated between the periods of own use and of letting out. Indeed, the obligation to prepare an income forecast applies, irrespectively of whether or not there has even been own use, if the taxpayer (for example, in a letting agency contract) simply reserves the right for own use.

» **Recommendation:** If possible, avoid the inclusion of an own use clause. Otherwise, an income forecast has to be prepared that takes into consideration all objectively discernible circumstances and, in individual cases, this can be complicated. Your PKF consultant will be happy to give you details about which types of income and costs can, or have to, be included in the forecast.

» **More Information:** The BFH ruling that was mentioned is from 16.4.2013 (case reference: IX R 22/12) and can be accessed online at www.bundesfinanzhof.de (German version only)

Inheritance tax levied on foreign assets – Double burden is not contrary to EU law but considerations of equity are permitted

» **Who for:** Legal heirs to foreign capital assets.

» **Issue:** In 2000, a taxpayer living in Germany received an inheritance that included, among other things, capital assets that were being managed in France. Inheritance tax was levied on these assets both in France and also in Germany, so that the overall tax charge was 84%. The heiress wanted to have the French taxes deducted from German inheritance tax (so-called offsetting). Ultimately, this was rejected by the Federal Fiscal Court (Bundesfinanzhof, BFH). In this case, it ruled - against the taxpayer - that the double taxation was not contrary to EU law. The Member States are not obliged to adapt their own tax systems to the different tax systems of other Member States in order to eliminate double taxation.

» **Recommendation:** In order to avoid the very considerable overall inheritance tax burden, in similar case, an application for equitable measures should be submitted. Here, in particular, an application for a partial waiver of German inheritance tax would be possible. In the ruling, mentioned above, while the BFH did not state any thresholds above which a partial waiver would be justified, at least, in an abstract manner, it expressly emphasised the principle of equitable measures.

» **More Information:** The BFH ruling in question is from 19.6.2013 (case reference: II R 10/12) and is available online at at www.bundesfinanzhof.de (German version only). Furthermore, it should be noted that, in

April 2009, an inheritance tax treaty between France and Germany came into force in which the offsetting of French tax is permitted. Therefore, according to the current legal position, the outcome of the case would have been different.

ACCOUNTING

Consolidating financial statements with different reporting dates – Avoiding problems related to the consolidation of group accounts

» **Who for:** Businesses that are obliged to prepare consolidated group accounts.

» **Issue:** The consolidated accounts of a company have to be prepared in correspondence with the reporting date of the annual financial statement of the parent company. For this, the reporting date of the annual financial statements of the subsidiary companies, that are fully or partially consolidated, should be consistent with that of the reporting date of the consolidated group accounts. However, it is also possible to opt for a reporting date for the annual financial statement that differs from the date of the consolidated group accounts. In this case, it is necessary to distinguish between two scenarios.

- If more than three months have elapsed since the end of the last financial year of the company that is to be consolidated, then an interim statement has to be prepared to serve as the basis for integrating the subsidiary into the consolidated group accounts. The interim statement should be prepared in accordance with accounting principles and take into consideration group-wide recognition and valuation methods.
- If less than three months have elapsed since the end of the last financial year of the company that is to be consolidated, then an interim statement can be dispensed with. In this case, events of particular importance that occurred between the end of the last financial year and the reporting date of the consolidated group accounts should either be taken into consideration in the group balance sheet and P&L, or specified in the notes to the consolidated financial statements. A statement in the notes to the consolidated accounts has to give a description in terms of content and present the effects on balance sheet and P&L items, ideally in the form of an additional calculation. A considerable difference between the items to be consolidated can be an indicator for the existence of significant events.

» **Recommendation:** In order to simplify consolidation, and to avoid having to give information about individual cases when significant events have occurred between the reporting dates, you should opt for a group-wide reporting date. If this is not possible, you should consider preparing an interim financial statement in order to avoid problems related to the consolidation.

Processing fees for loans – Immediately deductible or do they have to be capitalised as a deferred charge?

» **Who for:** Borrowers who prepare accounts.

» **Issue:** The accounting treatment of a processing charge, which a borrower undertakes to pay when a credit agreement is concluded, depends on whether or not the fee will be repaid (pro rata) to the borrower in the event of early termination of the contract. If reimbursement is contractually excluded, then the processing fee should not be capitalised as a deferred charge but, instead, it is immediately deductible as an expense. However, this does not apply if the loan can only be terminated for good cause and, additionally, if it is not possible to ascertain at the time the contract is concluded that the contractual parties want to make use of this entitlement. Indeed, in such a case, if it will be reimbursed, capitalisation of the fee as a deferred charge is mandatory. Furthermore, the fee always has to be capitalised as a deferred charge if reimbursement is specified in the loan agreement.

» **Recommendation:** If a borrower intends to treat the processing charge as an immediate expense, (possibly favourable for tax purposes), then, before the agreement is concluded, there should be a review to ascertain whether, or not the above-mentioned conditions for not capitalising expenses have been met and, if necessary, ensure that the appropriate structures for this are put in place.

» **More Information:** You can read about the above-mentioned principles in the Federal Fiscal Court (Bundesfinanzhof, BFH) ruling of 22.6.2011 (case reference: I R 7/10). This can be accessed at www.bundesfinanzhof.de (German version only).

LEGAL

Remaining annual leave in the event of a reduction in working hours – No pro-rata cut-back

Who for: Companies who employ staff on a part-time basis.

Issue: After both maternity leave and parental leave, a full-time employee, in the German Federal State of Lower Saxony, returned to employment on a reduced hours basis (three working days per week). The employer converted remaining annual leave of 29 days, which had arisen during full-time employment, to 17 days (3/5) in accordance with the ruling of the Federal Labour Court (Bundesarbeitsgericht, BAG).

The employee brought an action for a judicial declaration on the recognition of entitlement to 29 days of paid annual leave - and rightly so as the ECJ recently clarified on the basis of the BAG submission. It, thus, eliminated any remaining doubts as to whether or not this point of law, which was resolved in Austria in 2010 already, is transferrable to Germany.

The principle of calculating annual leave on a pro-rata basis only applies for leave accrued during part-time employment, and not for holiday entitlement acquired during full-time employment. The ECJ did not accept the argument that fewer days of leave were required in order to have the same amount of free weeks. As, with a three-day week, there is no obligation to work on two days anyway; effectively, such a week of leave cannot be compared with a week of leave in the case of five working days. What matters in this case is the "accrued" period of rest. This cannot be reduced retroactively if the employee works part-time later on.

Recommendation: The ruling, in principle, only applies to the statutory minimum annual leave. Therefore, for leave entitlement over and beyond this, the previous conversion method could be agreed upon in the employment contract. Alternatively, in the event of a planned or expected reduction in working hours, you should try to ensure that existing annual leave entitlement is taken before reducing working hours.

More Information: The ECJ decision from 13.6.2013 (case reference C-415/12, in the proceedings of Brandes) was published on the ECJ website (www.curia.europa.eu).

Distributions to limited partners – Repayment obligation only if it is explicitly stipulated in the articles of association

Who for: Commercial partnerships (especially public companies) that make distributions, not dependent on profits, to limited partners, even though, through losses or payouts, the partner's interest has already fallen below the level of the paid-in capital.

Issue: A limited partner had received distributions, based on a contractual agreement in the articles of association, that were not dependent on profits, even though this had led to a reduction in his agreed paid-in capital and the company was running losses. In the financial accounts, the distributions were recorded in the shareholder's "loan account". During the company's economic crisis, the issue was raised as to whether or not the limited partner was obliged to repay this distribution.

In this respect, the Federal Court of Justice (Bundesgerichtshof, BGH) decided that such a repayment obligation can only be stipulated in the articles of association. If the articles of association do not include a provision with respect to a repayment obligation then, the limited partner can be liable to the company's creditors because he has not provided his agreed paid-in capital. Internally, the partner is deemed to have fulfilled his obligation to provide paid-in capital through the paying in of the capital contribution in the first place.

Recommendation: A company has no recourse to a right granted by law to a repayment of distributions that have been granted under the terms of the articles of association. Therefore, an explicit provision with respect to an obligation to repay distributions has to be included in the articles of association. However, this is not a protection against potential direct creditor claims with respect to an existing, or renascent liability vis-à-vis third parties, moreover, the potential claim for a refund by an insolvency administrator also remains unaffected by this.

More Information: The above-mentioned rules can be found in the new BGH rulings from 12.3.2013 (case reference: II ZR 73/11) and from 25.6.2013 (case refer-

ence: II ZR 73/11) and are available online for downloading at www.bundesgerichtshof.de (German version only)

CORPORATE FINANCE

Credit management in the restructuring process

» **Who for:** Companies whose restructuring measures include partial debt forgiveness by credit institutions.

» **Issue:** Frequently, in restructuring negotiations (cf. article on basic strategies in the PKF Newsletter 01/2013), the aim is debt relief for the company. However, for companies, partial debt forgiveness by credit institutions usually entails the loss of the business ties with the former bank - which also means that one, or more, "paying agents" for incoming and outgoing customer and supplier payments are dispensed with. Against this background, the transition to new, stable banking relationships should always be planned carefully as this can be of crucial importance for a company's liquidity and hence the ability to survive.

Experience shows that, often, applications for new, or extended current account overdraft facilities form the focus of credit negotiations, as well as the rating and the development of trust that is associated with this.

(1) Caution is required in negotiations for current account overdraft facilities during the restructuring process – When applying for new, or extended current account overdraft facilities, which could potentially replace facilities that will be discontinued, parallel to this, negotiations about partial debt forgiveness should be initiated – even though credit negotiations, as a rule, can only be successfully concluded after partial debt forgiveness. Here, the amount of the current account facility is only one aspect. A frequently neglected problem arises when there are a considerable number of direct debit agreements with customers. This is because banks, mostly, put limits on the collection of potential returned direct debits in addition to the credit facilities that have been granted. If these are exceeded, the collection of further direct debits will be refused even though the current account overdraft facility has not been fully utilised. As a result of the closure of one or more bank accounts there is a risk that the entire volume of permitted debits could fall below the debit volume required for smooth payment procedures. In that case, despite existing direct debit agreements, customers would then have to be referred to credit transfers. Many customers lack the personnel resources for this. This, in turn, could result in delayed payments, credit losses or also loss of customers. Therefore, before the credit negotiations, it is essential to ascertain the required direct debit volume in order to be able to communicate this in the negotiation process.

» **Recommendation:** As part of restructuring processes, at least two current accounts should be retained or agreed in good time. In the event of partial debt forgiveness by a credit institution, a transitional period should be agreed during which incoming and outgoing payments can continue to be processed via the previous accounts. In the course of this, attention should be paid to the continued existence of the overall direct debit volume that is necessary. It is also important that once disciplined liquidity management has been set up it should continue permanently.

2) Rating and the development of a new situation of trust with creditors – As a rule in credit negotiations during the restructuring process, companies face the challenge of laying the groundwork for restoring the trust of the stakeholders such as, e.g. banks, suppliers and also credit rating agencies. In the course of this, all those who are involved expect the rating to be restored to creditworthy status on the basis of actual figures. For this, the historical data from the annual financial statements are suitable only to a certain extent, for obvious reasons, while the planning documentation prepared during the restructuring process, because it is forward-looking by nature, is not sufficient in negotiations for new credit lines. In the actual figures, the stakeholders want to see the beginnings of a successful restructuring.

» **Recommendation:** Credit negotiations should be backed up with current business data in the form of interim financial statements, although, there should be at least one quarterly financial statement available from after the restructuring. Besides presenting, separately, the "exceptional" restructuring results and the, actually more important, current results of the restructured company, try to ensure that the key performance indicators such as those relating to equity, as well as the maturity matching financing of the company, show a positive trend.

IN BRIEF

BMF circular on the Entry Certificate – Beware of the transition period.

On the 1.10.2013, there was a change in the documentary evidence requirements for intra-Community supplies. The details of the amendments, from the view of the authorities, are set out in the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) circular of 16.9.2013. With regard to this topic we would like to refer you to the presentation of this in the accompanying issue of the PKF Latest News (PKF aktuell - German version only). Apart from this, however, we would like to draw your attention once again to the fact that the above-mentioned directive includes a transitional period that runs to 31.12.2013, during which no complaints shall be made if the documentary evidence requirements provided for intra-Community supplies still comply with the old regulations. However, please be aware that, in the event of a legal dispute, the financial courts are not bound by these simplified regulations.

Tax pitfall in the case of the provision of a company car to an employee who lives outside of Germany

Through the Act Implementing the Mutual Administrative Assistance Directive (cf. earlier report in issue 7-8/2013), the place of performance in the case of the long-term leasing of vehicles to non-entrepreneurs was changed. The place of performance of these services is the place of domicile of the recipient. This also applies to company cars that are provided for use by employees. Therefore, if the employee, who is provided with a vehicle, lives outside of Germany, the employer now has to take into account the VAT consequences in the employee's state of domicile.

AND FINALLY…

"Transaction taxes have been discussed for many years, and, I expect, that they will continue to be discussed for many more years."

George Gideon Oliver Osborne (*1971), British Chancellor of the Exchequer

Impressum

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