PKF

Accountants &
business advisers

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Editorial

Dear Readers,

The end of the year is approaching and with it the coming into effect, on 1.1.2014, of various amendments to the tax law on travel expenses. In order for you to be able to make the necessary preparations in good time, we discuss the key points of the future legislation in the Focus section of this issue.

The subsequent tax related topics look at new court rulings. Firstly, they concern developments that are favourable for you, such as the payroll tax treatment of company events (which could be of significance for the upcoming Christmas parties!). Furthermore, recently, there was a confirmation of the previous ruling on chains of gift transactions, which have to drafted and executed with great care. Moreover, we have also provided information about restrictive tendencies. To this end, first of all, on p. 4 read more about the emerging risks associated with own use of holiday homes (when homes in foreign countries are owned via a corporation). Furthermore the tax accounting treatment with regard to dismantling obligations is uncertain because, in the case of lease agreements with options to extend, the legal situation has not been conclusively clarified to-date.

In this issue, our reports have been supplemented with articles on so-called “frequently discussed topics”. So, against the background of upcoming works council elections, in the spring of 2014, we have begun a series on the legal aspects, which have to be taken into account in this regard. The first article in this series is on p. 5; it presents the fundamental principles and, thus, creates a basis for in-depth discussion of individual questions in the following issues. Finally, in the Corporate Finance section, we present structuring options in connection with the so-called recapitalisation privilege in the case of an acquisition of a shareholding.

Yours sincerely,
Your PKF Team

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FOCUS

New law on travel expenses from 2014 on – What you should pay attention to

At the, upcoming, turn of the year, new legal provisions as well as a related circular issued by the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) will modify the previous income tax law on travel expenses in several ways. The following overview focuses on the amendments, most important for you, in connection with the newly introduced so-called first place of work ("*erste Tätigkeitsstätte*") as well as with travel and subsistence costs.

I. First place of work

According to the legal provisions, still applicable until the end of 2013, the regular place of work ("*regelmäßige Arbeitsstätte*") is a key point of reference for the tax law on travel expenses (more about that in issue 2/2012). In future, the so-called first place of work will assume this function. The determination of this will have an impact on both the tax base for travel costs as well as on the treatment of subsistence costs and/or the provision of meals. Determining the first place of work requires the utmost care, particularly in the case of employees with several places of work.

In principle, the first place of work is a fixed work place location of the employer, of an associated company, or a third party designated by the employer. An employer has to assign an employee permanently and clearly to the first place of work. The assignment shall be specified according to public sector employment law, or labour law. It is not necessary for the *qualitative* focus of the work to be in the first place of work (more on the quantitative criteria that need to be taken into consideration and which will be specified at the end of this section).

Whether, or not an assignment is deemed to be permanent depends on the employer's forecast at the beginning of the employment. If an employee is supposed to work in one place for an unlimited period, "until further notice", or for a period of more than 48 months, then the assignment shall be deemed to be permanent.

» **Please note:** Changes in the assignment by the employer should be taken into consideration only with respect to their impact for the future.

If the employer has not undertaken to determine the first place of work, then this has to be determined on the basis of *quantitative criteria*. The first place of work is then deemed to be the work place location where, typically, an employee is supposed to work every working day, or two full working days per working week, or at least 1/3 of his/her agreed working time. If there are several such places, then the first place of work shall be the place of work that is closest to the employee's home.

» **Please note:** Every employee may have a maximum of one first place of work for each employment relationship.

II. Travel Costs

The costs of an employee's travels between home, or the first place of work and an external place of work, or accommodation may be reimbursed tax-free by the employer. In this respect, if public transport is used then the actual costs incurred are applicable. If the employee uses his/her own motor vehicle for these journeys, it is possible to reimburse up to € 0.30/km tax-free if the business mileage is logged.

» **Please note:** However, if the employer provides a vehicle no costs may be reimbursed tax-free.

III. Subsistence costs

Subsistence costs may only still be reimbursed in the amount of the statutory allowances. Nevertheless, there have been changes as, in the future, the blanket allowance for absences of more than 8 hours and up to 24 hours will be a standard € 12. This rate will now also be granted if the work is carried out during the transition between two calendar days without an overnight stay. For absences longer than 24 hours, the blanket allowance will be € 24. For trips lasting several days, a blanket allowance of € 12 will be granted for the arrival day and the departure day, irrespective of the duration of the period of absence.

IV. Provision of meals

If, during a period of working away from home, an employer provides the employee with free or reduced priced meals then, in principle, for standard meals (up

to € 60) the value of the advantage shall be deducted as a benefit in kind. If an employee has the possibility to avail him/herself of a subsistence allowance, then the meals provided by the employer do not constitute remuneration. To offset this, the subsistence allowances shall be reduced pro-rata by € 4.80 for a breakfast as well as € 9.60 for a lunch or a dinner.

» **More Information:** The BMF circular, referred to above, is from 30.9.2013 and includes numerous examples based on the new regulations. It is available at www.bundesfinanzministerium.de (German version only).

Corporate Taxes

€ 110 tax exemption limit for company events – The BFH has extended the scope

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

» **Issue:** According to the settled case-law of the Federal Fiscal Court (*Bundesfinanzhof*, BFH), benefits granted by an employer for a company event (e. g. Christmas celebration, company anniversary) are not subject to payroll tax unless they exceed a tax exemption limit of, currently, € 110 per employee. But now, in two recent rulings, the BFH opinion has evolved in favour of employers and employees in the following way:

(1) Extent of costs to be included – In the case in question, an employer had invited his employees to a company event in a football stadium on the occasion of the company's anniversary. The costs for this pertained to, primarily, the hiring of the stadium, performance artists, catering and the event organiser. The BFH ruled that only the costs of benefits that could be consumed by the participants had to be included in the tax exemption limit, such as e. g. food, drinks and musical performances. The costs incurred for the external setting (such as room hire, or the fee for the event organiser) should, in principle, not be included in the tax exemption limit, as, according to the BFH, these do not constitute a personal gain for the employees.

(2) Inclusion of accompanying persons – In another case, it was not just employees who had participated in a company event but also the people who had accompanied them (in particular, family members). In this regard, the BFH clarified that the share of the costs attributable to family members who had also been invited should not be included (anymore) in the € 110 limit of the respective employee. According to this, the costs that have to be taken into consideration can, thus, be divided equally among all the guests, therefore, also among the employees' family members insofar as they took part in the event.

» **Recommendation:** The new ruling is favourable for both business owners and their employees, as, in this way, despite the continued existence of the € 110 limit, the financial scope for holding events that are not subject to payroll tax has been extended. It remains to be seen, whether, or not the tax authorities declare these rulings to be generally applicable, too. Likewise, please be aware that the tax exemption limit is applicable to a max. of two events per year.

» **More Information:** The BFH rulings from 16.5.2013, published on 9.10.2013, (case references: VI R 94/10 and VI R 7/11) are available at www.bundesfinanzhof.de (German version only).

Partnerships which provide asset management services – Caution is required if one of the shareholders is moving and/or has moved abroad

» **Who for:** Natural persons who hold an interest in a partnership which holds shares in a corporation and which provides asset management services and which is deemed commercial under German tax law, and who have moved or are planning to move, to a non-EU/non-EEA state.

» **Issue:** Previously, if the private assets of a natural person comprised more than 1% shares in a corporation and this person wanted to move to a non-EU/non-EEA state, in the past, often even before the move, s/he would transfer his/her share to a partnership deemed commercial under German tax law (e. g. a GmbH & Co. KG, a German limited commercial partnership), in order to avoid immediate taxation of the hidden reserves in the shareholding in Germany.

However, taking into consideration the more recent Federal Fiscal Court (*Bundesfinanzhof*, BFH) rulings on double taxation treaties (DTT), this approach will often not be effective in preventing taxation in Germany of the hidden reserves in existence in the shareholding on the date of the move if the partnership only provided asset management services. Furthermore, usually after the move, the ongoing income received by the partnership

from the corporation is taxable in Germany *to a limited extent only*. Moreover, the divestment of shares in the corporation by the partnership, possibly, may not be taxable in Germany *at all*. At least, this is applicable with respect to the hidden reserves that are created after a move.

The German government wants to counter these consequences by including the new Section 50 i in the German Income Tax Act, even in cases where a DTT provides for legal consequences other than those under the new provisions. Insofar as the transfer to the partnership took place prior to 29.6.2013, without any taxation of the hidden reserves, the following should apply:

- For divestments of shares in corporations, made after 29.6.2013, originating from a partnership, taxation in Germany of the disposal gain shall be obligatory.
- Ongoing income received via the partnership from the corporation shall be subject to German income tax even after the shareholder has moved abroad.

» **Recommendation:** The new provisions of Section 50 i in the German Income Tax Act are likely to be challenged in court since they are too complex. Thus we recommend, as a matter of urgency, that you should seek detailed advice on both a possible presentation of the facts as well as on potential legal remedies that could be put in place as objections to tax assessment notices.

» **More Information:** As part of the more recent BFH rulings, referred to above, the rulings from 28.4.2010 (case reference: I R 81/09) as well from 25.5.2011 (case reference: I R 95/10) are of significance. Both can be found at www.bundesfinanzhof.de in the “Entscheidungen” section (German version only).

Personal Taxes

Chains of gift transactions – Viewed separate or jointly?

» **Who for:** Individuals who transfer or receive assets which have been gifted several times in a row.

» **Issue:** If assets are transferred to an acquirer through gifting and if the same assets are gifted by the acquirer to another individual soon afterwards, for the purposes of gift tax, it is presumed that if the intermediate acquirer was obliged to pass on the item to the subsequent acquirer a direct transfer from the original owner to the last acquirer occurred. However, if no such obligation exits, from a tax point of view, this will be treated as two separate events.

Relevant for gift tax purposes is the extent to which the intermediate acquirer is obliged to pass on the item. To this end, as the Federal Fiscal Court (*Bundesfinanzhof*, BFH) confirmed in a recent ruling, all the objective circumstances of an individual case have to be taken into account. Besides the contracts concluded, this also includes, for example, the agreement on the contents as well as the assigned objectives behind the contract design. The court ruled in favour of the taxpayer that merely because the benefactor knows, or agrees with the fact, that the beneficiary of his/her gift will pass it on directly after the gifting to a third party, this is not sufficient reason to presume that there was an obligation to pass on the item. Even if the assets are only in the hands of the intermediate beneficiary for a short length of time, this in itself, is not an indication of an obligation to pass on the assets; however, within the scope of an overall assessment this could serve as a proof.

» **Recommendation:** Even if the new ruling confirms that there is still a wide scope of discretion, you should nevertheless continue to be careful when considering gift transactions that occur in quick succession. Insofar as you want to have two (or more) separate transfers recognised for gift tax purposes, it is particularly not advisable, to have one document that summarises both the original gift transaction and the subsequent gift transaction. As under such circumstances, in the opinion of the BFH, the initial beneficiary, usually, has no freedom of choice in relation to passing on the gift.

» **More Information:**The BFH ruling referred to was given on 18.7.2013 (case reference: II R 37/11) and is available online at www.bundesfinanzhof.de (German version only).

Tax pitfall in the case of unpaid “own use” of a holiday home

» **Who for:** Taxpayers who own a holiday property via a corporation.

» **Issue:** Own use of your own holiday home is, in principle, not relevant for tax purposes. The situation is different if the holiday property is not owned directly by the natural person who uses it but, instead, belongs to a corporation in which the taxpayer holds shares.

Recently, the Federal Fiscal Court (*Bundesfinanzhof*, BFH) ruled on just such a case. A holiday home, which was held by a Spanish corporation, had been made available to the shareholders for holidays all year round. Thus the company waived income in an amount equivalent to the

rent at market rates for providing the holiday home. In the opinion of the court, this waiver constituted a hidden profit distribution, which for German shareholders was taxable in accordance with the tax withholding scheme.

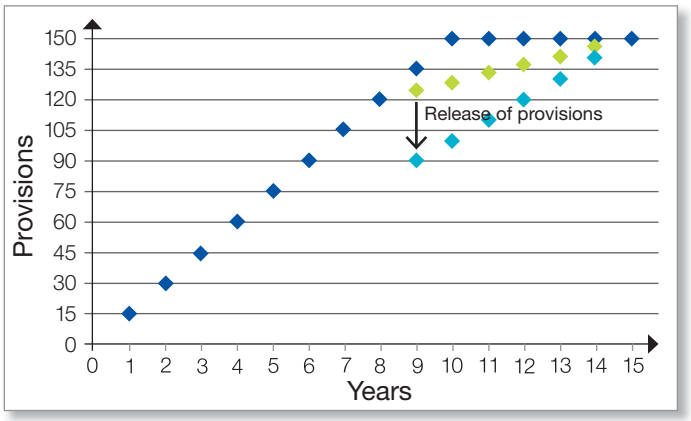
» **Recommendation:** In the above-mentioned case, the BFH had to give a ruling on the income tax consequences solely for shareholders in Germany. However, the free use can also result in tax charges at the corporation level if, for example, fictitious operating income has to be recognised in the company, or if withholding tax on the hidden profit distribution has to be transferred.

» **More Information:** The relevant BFH ruling from 12.6.2013 (case reference: I R 109/10) can be downloaded at www.bundesfinanzhof.de (German version only).

ACCOUNTING

Accounting treatment of dismantling obligations – Legal uncertainty in the case of options to extend the lease

» **Who for:** Business owners who, as tenants, have undertaken to remove fixtures and fittings added by them (so-called dismantling obligations) when the lease expires.



Auswirkungen auf die Rückstellung

» **Issue:** A tenant has to create provisions for dismantling obligations. Under commercial law, it is permissible to create the entire provision immediately, as well as to accumulate it in equal annual amounts over the course of the lease term. However, according to tax law, it is only permissible to accumulate the provision over the course of the lease term.

When the provision is accumulated over the course of the lease term, options to extend the lease also have to be taken into consideration when these options are exercised. With regard to the accounting treatment, there are two possibilities:

- Version 1: Spread the amount that has not yet been accumulated, on the date the option is exercised, over the remaining lease term, including the option.
- Version 2: Re-calculate the provision on the premise that, from the start, the accumulation had been over the course of the lease term, including the term of the lease option. As a result, in the year when the option is exercised, the provision could also, potentially, have to be partially released to income.

The effects on the amount of the provision are illustrated clearly in the following graphic. The blue line represents the original provision that was created. The green line illustrates Version 1. With Version 2 (red line) it can be seen that, initially, a release of the provision to income is required.

In the financial accounts both options are permitted. However, under tax law, current opinions differ in this regard as the tax court of Lower Saxony ruled in favour of Version 1, while the Hesse tax court has advocated Version 2.

» **Recommendation:** For clarification as to which ruling is applicable for tax purposes we will have to wait until the outcome of the appeal proceedings, before the BFH, that are pending against the rulings of the regional tax courts. Until then, in comparable cases, you should consider lodging an objection against rulings from the tax authorities that are unfavourable for you and pointing out that there is a suspension of proceedings until the expected BFH decision.

» **More Information:** Upon request, we would be happy to provide you with the above-mentioned rulings of the tax court of Lower Saxony from 10.5.2012 (case reference: 6 K 108/10) and of the Hessen tax court from 21.9.2011 (case reference: 9 K 1033/06).

LEGAL

The upcoming works council elections require careful preparation

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

» **Issue:** In many companies, with a normal election cycle, works council elections, which in principle happen

every four years, will be due in the period from 1.3.2014 to 31.5.2014. Outside of the normal election cycle, works council elections take place, in particular, at companies where no works council existed previously, if the works council has stood down, or if the works council election has been contested. The following main aspects should be taken into consideration when preparing and conducting works council elections:

(1) Conduct of the election – The elections are held at the instigation of the employees. However, the polling day has to be within the specified period of time. Moreover, an election committee has to be appointed by the previous works council no later than ten weeks before the expiry of its term of office. The election committee shall initiate and conduct the election and, finally, ascertain the results of the election. In principle, the election shall be conducted during working hours and may not lead to a salary reduction for the participating employees.

(2) Candidate nominations – These can be submitted by both employees who are entitled to vote as well as by the unions represented in the company. Although, nominations submitted by employees, as a rule, have to be signed by at least one-twentieth of the employees who are entitled to vote, while the nominations from unions by two representatives.

(3) Election procedure – The works council shall be elected directly by secret ballot. The election procedure prescribed by law shall be in accordance with the principles of proportional representation ("election by list"). Here the electors vote for a predetermined list. Once the results of the vote count are known then each list will be proportionately allocated the number of seats obtained on the works council; in the course of this, the seats will be allocated according to the order in which the candidates appear on the list. By way of derogation from this, in the following cases the election may be conducted in accordance with the principles of majority representation ("voting for an individual", i.e. the elector votes directly for a candidate):

- if only one list of candidates is submitted,
- the company has not more than 50 employees, or
- if, in companies of between 51 and 100 employees, the election committee and the employer agree to an election in accordance with the principles of majority representation.

» Recommendation: It is not only in the interests of employees but also of the employers to ensure that works councils elections are properly conducted, as procedural errors can entail considerable costs. Therefore, all sides would be well advised to become familiar with the relevant provisions and to ensure that they are complied with.

» More Information: It can be seen that with respect to works council elections there is a large number of legal aspects that have to be taken into account. In the next two issues of the PKF Newsletter we will be taking an in-depth look at the most important ones. In particular, we are planning articles on the structuring options available beforehand and possible reactions to errors in the electoral process.

Renewed legal uncertainty with respect to fixed-term contracts

» Who for: Companies who employ staff on a temporary basis.

» Issue: The restriction of an employment contract with regard to its duration is permissible without an objective reason for a period of up to two years. However, this does not apply if, previously, a fixed-term contract or a contract for an indefinite term had already existed with the same employer. According to the latest ruling of the Federal Labour Court (*Bundesarbeitsgericht*, BAG), there is no "previous employment" within the meaning of this provision if, at the time a new contract is issued, the last employment relationship with this employee dates back more than three years.

However, in a recent ruling, the higher labour court (*Landesarbeitsgericht*, LAG) of Baden-Wuerttemberg disagreed with the BAG. After two contract extensions, the claimant had been employed on a temporary basis for a total period lasting from 1.2.2011 up to 31.1.2013. An employment relationship with the same employer had already existed in 2007. The LAG ruled in favour of the claimant and assumed that an employment relationship of indefinite duration had come into existence. In the opinion of the LAG judges, the previous BAG ruling went beyond the boundaries of the development of the law by judicial interpretation. The text of the statute is clear – from the legislative procedure it can be discerned that the intended purpose of the law was not to include any restrictions in the legislation.

» Recommendation: Once again, there is legal uncertainty, as a result of this LAG ruling. Even if a former employment relationship already dates back more than 3 years, caution is required from the point of view of the employer when concluding fixed term contracts, without giving objective reasons, with previous employees.

More Information: The above mentioned LAG Baden-Wuerttemberg ruling is from 26.9.2013 (case reference: 6 Sa 28/13) and is available online at www.lag-baden-wuerttemberg.de (German version only). In this the LAG challenges, among other things, the BAG ruling of 6.4.2011 (case reference: 7 AZR 716/09) which is available online at www.bundesarbeitsgericht.de (German version only).

CORPORATE FINANCE

Recapitalisation privilege for creditors who acquire a shareholding – Have the conditions been met?

Who for: Creditors who, for recapitalisation purposes, would like to acquire a shareholding in a debtor enterprise in crisis.

Issue: In insolvency proceedings at limited liability enterprises, shareholder loans and comparable legal acts are, in principle, subordinated. As a consequence, once other creditors have been satisfied, shareholders run the risk of not having their loans repaid. As an exception to this, under certain conditions, the German Insolvency Statute provides for a privilege for creditors who, for recapitalisation purposes, acquire a shareholding. If this so-called "recapitalisation privilege" is applicable then the loans granted up to the acquisition of the shareholding, will at least not be subordinated but, for the duration of the crisis, will, instead, continue to be treated like loans from third-party creditors. However, the application of the recapitalisation privilege is subject to strict conditions, in particular, the following seven aspects should be taken into consideration.

(1) Type of shareholding – It is not relevant whether the share is acquired from previous shareholders or as part of a capital increase, i. e. it does not matter whether or not fresh capital is transferred to the enterprise as a result of the acquisition of the shareholding.

(2) Acquisition of shareholding by creditors – According to the text of the statute, the shareholding has to be acquired by an already existing creditor of the enterprise. If a loan is granted for the first time on the date of the acquisition of the shareholding, or after it, according to most of the prevailing opinions in legal literature and comments it should, however, be sufficient if the granting of the loan coincides with the acquisition of the shareholding.

(3) Exclusion of previous shareholders – In principle, the creditor may not have previously been a shareholder of the enterprise in need of recapitalisation.

(4) Acquisition for recapitalisation purposes – Preferential treatment is only possible for acquisitions made for recapitalisation purposes. For this, it is essential that, viewed objectively, at the time of the acquisition of the shareholding,

- the enterprise can be recapitalised and
- that the measures that have already actually been implemented are, overall, appropriate for an effective recapitalisation of the enterprise.

Objective evidence that an enterprise can be recapitalised may be provided in the form of a recapitalisation plan prepared in accordance with the provisions in the standard published by the Institute of Public Auditors in Germany (*Institut der Wirtschaftsprüfer*, IDW) – "Requirements for the preparation of recapitalisation concepts" (IDW S6).

(5) Date of acquisition – The acquisition shall occur at a time when the enterprise is already insolvent, insolvency is imminent, or if there is over-indebtedness.

(6) Time limit – The recapitalisation privilege shall apply only until such time as the recapitalisation becomes sustainable. The latter, in particular, implies that the risk of insolvency, or over-indebtedness, has been averted for, at least, the current financial year and the entire subsequent financial year and that the company's ability to continue as a going-concern is also possible without the recapitalisation shareholder.

(7) No repeat privilege – If there is a new crisis then the recapitalisation privilege does no longer apply. In this case, an existing shareholder loan would be subordinated.

Recommendation: The acquisition of a shareholding affects the companies involved in a variety of ways. For example, it can lead to the elimination of tax losses and tax loss carry-forwards, or the write-downs on loans being taken into consideration for tax purposes. Before acquiring a shareholding it is essential to make a careful analysis of the company and to seek tax and legal advice. The experts at PKF would be happy to help you.

More information: Further information on recapitalisation concepts and the compatibility of IDW S6 with the requirements of the ruling of the Federal Court of Justice (*Bundesgerichtshof*, BGH) can be found in a PKF Special on recapitalisation from June 2011, which can be down-

loaded at www.pkf.de (German version only). You can read an article that discusses the possible ways of limiting the effort involved in preparing recapitalisation concepts in accordance with IDW S6, especially for SMEs, by PKF author Roland Püschel in KSI, a German language professional journal in the field of restructuring. The article was published in issue 02/2013, p. 53 ff.).

IN BRIEF

BFH tolerates unpaid overtime where there is an employment relationship with relatives

In many smaller companies and micro-enterprises, relatives make use of employment opportunities. Now, a new ruling of the Federal Fiscal Court (*Bundesfinanzhof*, BFH) with regard to this issue has to be taken into account. In this the BFH commented generally on the arm's length criterion of agreements that have been concluded and, particularly, how to deal with unpaid overtime. The BFH explained (ruling of 17.7.2013, case reference X R 31/12), that with employment contracts between close relatives, the intensity of the necessary checks with regard to the arm's length nature of the contract terms also depends on the reason for the conclusion of the contract. Insofar as the relative who works as an employee performs unpaid overtime over and above the contractually agreed number of hours, this does not preclude the assumption that the employment relationship has indeed been carried out. More information will follow in the next issue.

Income tax – The offsetting of foreign tax credits is on a provisional basis only

In a circular dated 30.9.2013, the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) made it known that, until there is a legal reform, the calculation of the maximum amount of foreign tax that can be offset against German income tax shall be on a provisional basis only. The background is a decision by the ECJ from 28.2.2013 (case reference: C-168/11), in which the calculation for the tax credit limitation is deemed to be contrary to EU law as the method does not take special expenses and extraordinary burdens into consideration. The local tax office has to grant an exemption of enforcement for the amount of foreign tax not credited as a result of this.

AND FINALLY…

"Politicians allow themselves to be defined as people who attempt to solve political challenges with other people's money."

Lothar Schmidt, political scientist (*1922)

Impressum

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