PKF
Accountants &
business advisers

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Editorial

Dear Readers,

Customs law and customs clearance present a huge challenge because a wide range of increasingly complex regulations have to be taken into consideration. In the "Focus" section of this issue we deal in depth with the **imports side** and give **recommendations with respect to the proof of origin of goods**. In the next issue, we will be focusing on customs audits for the purpose of export control. Here is just a foretaste: the implementation of customs-audit-proof processes and internal controls is practically mandatory.

Employees who work abroad and their spouses would, understandably, also like to benefit from **income-splitting between spouses**. In the "Tax" section, we have a report on the conditions under which this is applicable even if husband and wife are **not resident (for tax purposes) in Germany**. Verifiable evidence is recommended not only for customs purposes but also when **apportioning the purchase price between buildings and a plot of land**. This was the advice in a recent Federal Fiscal Court ruling, which we discuss subsequently.

In the "Legal" section, as a complement to the Focus section, you will find an overview of the changes that will ensue under the U**nion Customs Code** as of 1.5.2016.

Although administrative fines of more than €1 bn have meanwhile been imposed, the **disclosure requirements under German GAAP** have not produced the desired **publicity** – in the "Accounting" section you can read about the responses to this. In any case, companies will have to take action in order to implement changes in the **Accounting Directive Implementing Act**. We have analysed the extent to which group companies will have to reclassify **intra-group cost recharges** as sales revenues.

The **CAPM** is a Nobel Prize-winning model in the field of company valuation. In our "Corporate Finance" series, we show why for some research academics the adaptations **that have been made to the model for its practical application have gone too far.**

Yours sincerely,
Your PKF Team

Contents

FOCUS

Organisational recommendations with respect to customs law – Part A: Proof of origin of goods for the purpose of import control

Certain aspects of customs legislation are becoming more and more important in view of the international interconnectedness of business. On the imports side, there is the frequent problem that it is only several years after goods have been imported that those liable for duty inland are confronted, by customs, with the possibility that they might have been misled as regards the origin of the goods. If customs then wishes to subsequently impose the regular customs duty, or even anti-dumping duties, what matters is who was obliged to provide proof of the origin of the goods.

1. The relevance of the origin of goods for those liable for duty

The origin, i.e. the place of provenance of a product, is of crucial importance with respect to the imposition of duties at the borders of the EU. This is because not all goods are subject to a standard import duty. In some cases, additional anti-dumping duties are imposed in order to protect European competition. The Commission, usually at the request of a producer within the EU, will check whether or not a manufacturer from a third country is offering its products at a price below which it is able to manufacture them under market conditions (so-called dumping). If the outcome of the check is positive then a regulation is issued according to which goods in a particular category with a particular origin become subject to an anti-dumping duty. Therefore, the issue of whether or not a product falls under this anti-dumping duty depends very heavily not only on its categorisation but also on its origin.

Obtaining preferential tariffs by devious means will result in the subsequent imposition of duties

However, in some cases, imports are also accorded privileges by reducing the regular duty rate (a so-called preferential tariff) if they have a particular origin. This especially applies to goods that originate from countries that have preferential status because, for political reasons, the economic growth there is being promoted.

2. Mechanisms for circumventing anti-dumping duties or obtaining preferential tariffs by devious means

Sometimes, producers and exporters take advantage of the rules of origin in order to be able to offer their goods more cheaply than the competition. For example, in individual cases, rules of origin circumstances are used to move the origin of the goods to a country whose goods are not associated with an anti-dumping duty. In addition, the countries selected for the origin of the goods are frequently those whose goods benefit from preferential tariffs.

Yet, this is not anything irregular insofar as moving the place of origin is not merely for the purpose of circumventing chargeable events for customs duties by concealing the true origin. However, the latter does happen repeatedly and those liable for duty inland only find out about this when the customs service subsequently requests them to pay anti-dumping duties, or the normal third country duty. Ultimately, the customs service holds those liable for duty to be responsible if, for example, on account of investigations by the European Anti-Fraud Office (OLAF) in the country of origin, the customs service has doubts that the origin of the goods was declared correctly. Those liable for duty will receive a notice of subsequent recovery of duties even if they could not have had any reason to doubt the declared origin of the goods.

» Please note: The problem is exacerbated further as, under European customs legislation, the protection for bona fide acts, in order to safeguard the importer from false statements made by the exporter, is wholly inadequate.

3. Application of rules concerning the burden of proof for the subsequent imposition of duties

With respect to the issue of the legality of the subsequent imposition of duties, on the basis of customs assessment notices, the general rules concerning the burden of proof pertaining to tax law are applicable. The customs administration is obliged to furnish proof for the circumstances that justify a customs claim. Those who are liable for duty have to provide evidence of circumstances that serve to reduce or eliminate a customs claim.

This shall not apply if criminal proceedings under customs law are initiated against those who are liable for duty. In those cases, the burden of proof lies entirely on the investigating authorities (in dubio pro reo). Thus, in proceedings relating to the subsequent imposition of duties, there are different standards of proof. The customs authorities have to provide evidence that the goods originated from a country against which anti-dumping duties have been imposed, while those who are liable for duty have to provide evidence for the preferential tariffs, namely, that the goods originated in a beneficiary country.

» Please note: It should be noted that the requirements with respect to the burden of proof may change at any time due to financial court rulings.

Frequently, those liable for duty inland (in Germany) do not even have the appropriate tools for verifying the origin of goods. For example, a certificate of origin from the exporting country is not sufficient if this was obtained by the exporter on the basis of deception. The issuing authority may also revoke certificates of origin and they would then be useless as evidence. In contrast, the customs service is in a better starting position as it has the possibility of carrying out investigations abroad, via OLAF, and requesting information from the customs authorities in the exporting countries in order to obtain knowledge about the actual origin of the goods.

» Please note: Experience shows that, in the event of OLAF investigations, authorities in the exporting countries are also quickly willing to revoke their certificates of origin.

Something that is encouraging for companies is the tendency for court rulings to tighten up requirements with respect to the burden of proof that the customs authorities have to provide. For Hamburg's tax court, which is frequently the competent court, merely ascertaining that there is an OLAF foreign mission with regard to the origin of goods is no longer sufficient grounds for the subsequent imposition of an anti-dumping duty. Increasingly, the manner of the investigations and the conclusiveness of the findings from OLAF are being checked (cf. ruling by Hamburg tax court from 11.9.2015, case reference 4 K 84/14).

» Recommendation: Businesses that are liable for duty should implement processes and internal control systems in order to be prepared for a subsequent imposition of duty. In particular, this includes:

- ongoing monitoring of anti-dumping regulations,
- checking the origin of goods locally, as well as
- regressive agreements with the exporter.

More Information: In the next issue we will be focusing on customs audits for the purpose of export control. After a description of the basic procedure for a customs audit, we will take a closer look at preferences and foreign trade audits.

TAX

Income-splitting between spouses in the case of notional restricted tax liability – Checking income limits

» Who for: EU citizens whose spouses or partners would like to apply to be treated as having unlimited tax liability in Germany.

» Issue: Upon application, those who are non-resident for tax purposes in Germany can opt to be treated as having unlimited tax liability. The advantage is that unlimited tax liability entails a whole series of tax advantages (e.g. a basic tax-free allowance, special expenses can be deducted, etc.). This is on condition that

a) at least 90% of worldwide income in a calendar year

has to be subject to German income tax (relative materiality limit)

b) or the foreign income should not exceed the basic tax-free allowance (in 2016: € 8,652) (absolute materiality limit).

Income-splitting between spouses – this can also have a positive impact on the tax charge of those who are married and non-resident for tax purposes

Depending on the country of residence, the basic tax-free allowance should potentially be taken into account on a pro-rata basis only, at 75%, 50%, or 25%. This can be ascertained from the country group classifications that are published annually by the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF).

In addition, according to Section 1a(1)(2) of the German Income Tax Act, EU/EEA nationals can apply to be jointly assessed for tax with their spouse, or partner - irrespective of his/her nationality.

Moreover, the hitherto opinion of the tax authorities was that the above-mentioned materiality limits had to be tested in two steps:

- First of all, it had to be established whether or not the taxpayer, as an individual, fulfilled the materiality limits.
- In the event of a positive outcome, the second step involved checking to see if both taxpayers jointly fulfilled the materiality limits (when the basic tax-free allowance is doubled).

An action was brought against this opinion by a retired married couple, living in Austria, whose joint income was below the doubled basic tax-free allowance. However, on his own, the husband generated higher income. The legal action was successful both at the financial court as well as at the Federal Fiscal Court (Bundesfinanzhof, BFH), in its ruling from 6.5.2015; it was the view of the courts that for a joint assessment for tax there should be no testing in stages of the pre-conditions.

» **Recommendation:** By publishing the ruling in the German Federal Tax Gazette (Bundessteuerblatt, BStBl) (BStBl. I 2015 p. 957), the tax authorities have declared it to be generally applicable. In future, for such scenarios (especially in the case of cross-border commuters), the advantages of a joint assessment for tax should always be reviewed. The same applies retroactively insofar as the tax assessment case remains open, e.g. in the event of an appeal.

» **More Information:** The above-mentioned ruling was issued under case reference IR16/14 and can be accessed at www.bundesfinanzhof.de. (German version only).

Dividing up the aggregate purchase price for plot of land that has been developed – standard and exceptional cases

» **Who for:** Taxpayers who are in the process of acquiring a plot of land that has been developed, or plan to do so in the near future.

» **Issue:** In its ruling of 16.9.2015, the Federal Fiscal Court (Bundesfinanzhof, BFH) clarified that when apportioning the purchase price between the plot of land and the buildings, in principle, the contractually agreed values are relevant. However, the prerequisite for this is that the result should be consistent with values that can actually be realised, i.e. the apportionment of the purchase price should not be illusory and may not constitute abusive use. In the case in question, the taxpayer wanted to carry out the apportionment in accordance with the purchase contract, however, the tax authorities rejected this and carried out the allocation on the basis of a report, prepared by a building expert, with a significantly different value.

In the opinion of the BFH, the values that can actually be realised will be substantially affected by indicative land values. Nevertheless, this initial indication could be overridden by other particular aspects, such as e.g., the spe-

cific features of the fixtures and fittings of the building, its original cost of construction, or a restriction on the usability due to the existing rental contracts. The upshot is that the apportionment that is carried out has to reflect the values that could objectively be achieved in the market and not merely a purely tax-based allocation criterion, for example.

However, in practical terms, it should be assumed that the apportionment that has been carried out in the purchase contract is relevant, in principle, and that it can provide an assessment basis for the depreciation on the building. If there are appreciable doubts in this respect, only then will the local tax office (have to) perform a specific valuation based on indicators arising from the overall circumstances.

» **Recommendation:** The recent BFH ruling makes it clear, once again, just how important it is to agree on an objectively verifiable apportionment of the purchase price in the purchase contract when you acquire a plot of land that has been developed. In order to obtain specific and tax optimised advice in connection with the purchase of a developed plot of land, it is of crucial importance to engage professionals with the appropriate expertise at an early stage and already when the contract arrangements are being made. Please do not hesitate to contact your PKF team in this regard.

» **More Information:** You can look up the ruling online under case reference IX R 12/14 on the BFH website – www.bundesfinanzhof.de (German version only).

LEGAL

The Union Customs Code is coming – An overview of the main changes

» **Who for:** Companies that have foreign trade operations.

» **Issue:** On 1.5.2016, after 22 years, the Community Customs Code will be replaced by the Union Customs Code (UCC), together with its implementing provisions. In principle, the existing approvals, procedures and decisions will be kept. However, the Customs Authority will review the approvals for customs procedures by 1.5.2019.

With this new code the EU wants to bring customs law into the digital age. The introduction of the planned IT-based customs clearance will be phased in by the end of 2020. Changes that do not require IT adaptations will be applicable already from 1.5.2016. The objectives include:

- Electronic information exchange between companies and authorities
- Simplification of customs designations
- Additional advantages for authorised operators
- Improved risk analysis with growing requirements for data transmission
- Introduction of corrective measures in the event of irregularities
- Harmonisation of processes in the EU

Within the overall framework of the changes the following eight aspects are of particular significance:

(1) Origin of goods and preferences – In future, long-term suppliers' declarations can be valid for two years. Retroactive long-term suppliers' declarations may only be issued if the start of the supply period was not more than one year ago. This restriction does not apply to individual suppliers' declarations.

(2) Customs value and customs debt – The prices paid by buyers in the first or earlier sales (so-called First Sale Rule) may no longer be applied and, in future, licence fees will also be dutiable if there is a third party licensor. It will be possible to remedy errors in customs declarations and these will no longer automatically give rise to customs debt.

(3) Temporary storage – Temporary storage, for the period between the presentation of the goods and the time when they are given a customs designation, will now only be possible in formally "approved depositories". Approval will depend on, among other things, the security measures in place. Clarification is still needed with respect to the extent to which temporary storage facilities that have hitherto been used may be transformed into "approved depositories". From now on, the standard maximum storage period will be 90 days.

(4) Binding tariff information – In future, binding information will only be valid for three years instead of the current period of six years.

(5) New electronic system for the status of products (Community products and, in the future, Union products) – In the medium term (planned for 2017), this system will replace the existing paper proof of status forms T2L and T2LF.

(6) Approved exporter (local clearance procedure): In Germany, the approx. 17,000 existing authorisations should successively be switched to the simplified customs declaration procedure (Art. 166 UCC). This should not constitute a degradation in terms of content and will be implemented by May 2019 within the scope of the review of authorisations.
(7) Oral export declaration – This will still be possible for commercial consignments up to a value of € 1,000 and/or a weight of up to 1,000kg, but will be effectively eliminated for imports.
(8) AEO (Authorised Economic Operator): A new condition for gaining approval as an "authorised economic operator" is "practical standards of competence or professional qualifications directly related to the activity carried out" for the respective officials responsible for customs in the company. Practical standards of competence are understood to be, among other things, three years' practical experience in the activity carried out.

» **Recommendation:** Our recommendation for all companies would be to set up a project platform with the aim of creating a better overview of the relevant regulatory changes so as to be able to address these if required. Your PKF consultant would be very pleased to provide you with support when you work out your approach for resolving any issues that arise.

» **More Information:** The UCC, as well as its implementing provisions are accessible online at www.eur-lex.europa.eu.

ACCOUNTING

Disclosure requirements under German GAAP – Can EU guidelines lead to a reform?

» **Who for:** Companies that are required to publish their annual financial statements.

» **Issue:** The Federal Office of Justice has been pursuing infringements of the obligation to publish annual financial statements since 2007. Nevertheless, to date, the Federal Office of Justice has still not succeeded in bringing about the acceptance of off-market publicity that the German government had expected. Yet, the authority cannot be reproached for a lack of commitment in pursuing infringements of the disclosure regulations. The sum of the administrative fines that have been determined since 2007 amounts to more than €1 bn and has, thus, exceeded the forecast, provided by the legislators, a hundredfold. Moreover, in recent years, the number of lawsuits involving administrative fines has not fallen.

The original idea behind disclosure was to provide the potential creditors of a corporation with the opportunity of finding out more about the creditworthiness of an enterprise. However, in the case of small and medium-sized companies, on the basis of the information that is disclosed, this is rarely possible in practice. Frequently, the information is already outdated, as the disclosures only have to be made within a year after the balance sheet date, and they are too sparse to give a clear picture of the financial position. Financial institutions therefore rely on their own rating systems. Thus, in practice, the legislation on disclosure requirements has not achieved its aims.

European legal specifications, from several ECJ rulings in recent years, provide less stringent requirements with respect to the disclosure obligation of companies as well as with regard to sanctions in the case of infringements. Thus, in future, discretionary decisions with respect to the proportionality of a disclosure could help and, potentially, companies with no, or only few liabilities to unrelated third parties, for example, could be exempted from individual or even all of the disclosure requirements.

» **Recommendation:** It remains to be seen when national courts as well as the legislature will converge with European regulations. We will keep you informed in this respect. We would be very pleased to advise you on your current obligations concerning the publication of annual financial statements.

The definition of sales revenues in the German Accounting Directive Implementing Act – Consequences for intra-group cost recharges

» **Who for:** Enterprises that perform intercompany settlements (revenues and expenses) between their affiliated companies.

» **Issue:** As of the 2016 financial year, on the basis of a new definition specified in the Accounting Directive Implementing Act (Bilanzrichtlinien-Umsetzungsgesetz, BilRUG), sales revenues will include many types of income that were hitherto reported under other operating

income, or extraordinary income. The criterion "related to ordinary business activities" as a feature for the recognition of sales revenues has been eliminated. As a result, sales revenues will increase and this will in particular affect income from the provision of services. According to the new version of Section 277(1) of the German Commercial Code, there is only one condition that needs to be satisfied for a transaction to qualify as sales revenue, namely, the existence of an exchange of services. In principle, in this case, it does not matter whether a company renders the service as a shareholder of the recipient of the service or as a third party. Nevertheless, income from cost recharges has to be viewed differently with regard to the specific reason that gives rise to it:

(1) Group service – If the income results from the provision of services that are (can be) charged for on the basis of their use, as there is an underlying exchange of services, the group company providing the services is deemed to be generating sales revenues. This includes many services from the IT support, legal, human resources and financial accounting areas.

(2) Apportioned costs – Insofar as a group company – usually an (intermediate) holding – recharges expenses and costs arising from an external relationship on the basis of secondary ratios or allocation keys, such as the number of employees, usable area, etc., then this does not lead to sales revenues as defined above.

» **Recommendation:** We recommend analysing intra-group cost recharges in terms of a (possible) settlement of actual performance entitlement (sales revenues) and a pure allocation of expenses and costs (other operating income).

CORPORATE FINANCE

Company valuation in academic research and practical application – An analysis based on the example of the Capital Asset Pricing Model (CAPM)

» **Who for:** Businesses that carry out valuations of their own enterprises by themselves as well as their advisers.

» **Issue:** Simplified valuation methods, such as the multiples valuation method, are frequently used in practice. In the case of other valuation methods, too, in practice the method or the derivation of the parameters are, more or less, simplified when compared with the model as it was originally developed by academic researchers.

Wirtschaftsprüfer (German Public Auditors) should basically be guided by the standards laid down by their professional association with respect to the principles for performing company valuations (IDW S1). According to this standard, simplified valuation methods, such as the multiples based technique, should merely provide a basis for performing plausibility checks. By contrast, in both IDW S 1 as well as in business management literature, the CAPM is deemed to be a suitable approach for calculating the cost of capital and, in the practice of valuing companies, it has prevailed.

However, the views of those in academic research and those who apply the model in practice are very different as the following exploration of the evolution and application of the CAPM shows.

(1) The objectives in academic research and in the practical application – Academic research is a system for gaining knowledge about essential characteristics, causal relationships and norms that is recorded in the form of concepts, categories, measurements, laws, theories and hypotheses. In application-oriented academic research (unlike in philosophy) the only theories that survive are the ones that work effectively in practice. Research studies are characterised by precision, reproducibility and consistency.

By contrast, in the practice of valuation, business interests are usually important. Self-created, pertinent solutions, which would not stand up to academic scrutiny, often have to be provided at short notice. In practice, the deadlines that are set are frequently linked to own financial income so that, for economic reasons alone, it is not possible to wait for an academically proven solution. Moreover, in some cases, a deliberate choice is made to refrain from using an academically correct solution in the valuation report.

(2) The development of the CAPM in academic research – The CAPM was developed in the 1960s by various academics working in parallel. The starting point for all approaches is whether at a point in time, t = 0, an economic entity should spend or save a given starting amount in order to spend an amount that will have been profitably invested at t = 1. In the course of this, a decision has to be made as to whether the investment should be risk free or should entail risk with respect to the return that can be achieved. The optimum portfolio structure for risky investments does not depend on the degree of risk aversion and is the

same for all market participants. They will all be perfectly diversified, i.e. the same information is available to all market participants. This basic CAPM framework is important in academic research. The joint developers – William Sharpe and Harry Markowitz – were awarded the 1990 Nobel Prize for this.

(3) The CAPM became more practical ...: The model was further developed by including other parameters. For example, there were attempts to incorporate inflation, tax and a longer period into the model. However, as a consequence, in practice the derivation of the parameters became increasingly pragmatic and "unacademic" but this was done under the label of an academic model. In the assessment of assumptions another boundary between the practical application and academic research has become blurred.

(4) ... and academic researchers distanced themselves – In the specialist literature there were differing opinions about this trend towards adapting the CAPM for practical application. William Sharpe believes that realistic assumptions are of secondary importance, as it is the results of the model that matter. This opinion remains the exception, however. In research and teaching, the practice of valuing companies using a model without appropriate assumptions has been largely rejected. In the opinion of Professor Kruschwitz, professor for financial management, who is particularly well known in Germany in the field of investment, as well as many other academics, the CAPM has failed. John Lintner, a co-developer of the CAPM, wrote: "It's just theory".

» **Recommendation:** Even if the CAPM in its practical application has been largely rejected by academics it is still accepted by companies, consultants and courts. Nevertheless, all those involved should be aware that a model can only be as good as the quality of the assumptions and of the derivation of the parameters used. Otherwise, when calculating rates for the cost of capital on the basis of the CAPM, the accuracy will be merely spurious. Nevertheless, the CAPM provides a framework. Significantly more freedom is provided by valuation approaches that were developed without any academic background, such as the multiples method. For your next valuation we would be pleased to outline the respective theoretical principles and the modifications that have been made so that you are get a clearer picture of the alternative valuations that have emerged. Moreover, you should use a valuation method that is tailored to the purpose of each particular valuation.

AND FINALLY…

"Some investments do have higher expected returns than others. By and large they're the ones that will do the worst in bad times."

William F. Sharpe, born 16.6.1934 in Cambridge/Boston, US American economist and Nobel Prize winner

Impressum

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