PKF

Newsletter

Key Issue:
Partnerships with option for corporation tax – Draft legislation has been put forward

04|21

Dear Readers,

Long-awaited **draft legislation on the Modernisation of Corporation Tax Law** was surprisingly put forward by the German government on 17.3.2021. One of the aims of this legislation is to give **partnerships** the option of being treated as **corporations** for tax purposes from 1.1.2022; we report on the main features of this draft in the first contribution in our Tax section.

For the Key Issue in this edition, we have however selected the following **contribution on BREXIT** - the transition phase has come to an end and in the case of VAT and customs the UK has been treated as a third country since 1.1.2021. While the changes relating to VAT are comparatively easy to implement, **problems and questions** have arisen in the first three months, in particular, on the **subject of customs.** Despite the conclusion of a Trade and Cooperation Agreement (TCA) between the EU and UK, imports from and exports to the UK are only tariff-free if certain conditions are met. **Preferential origin** requirements and proof that they have been satisfied play an important role here.

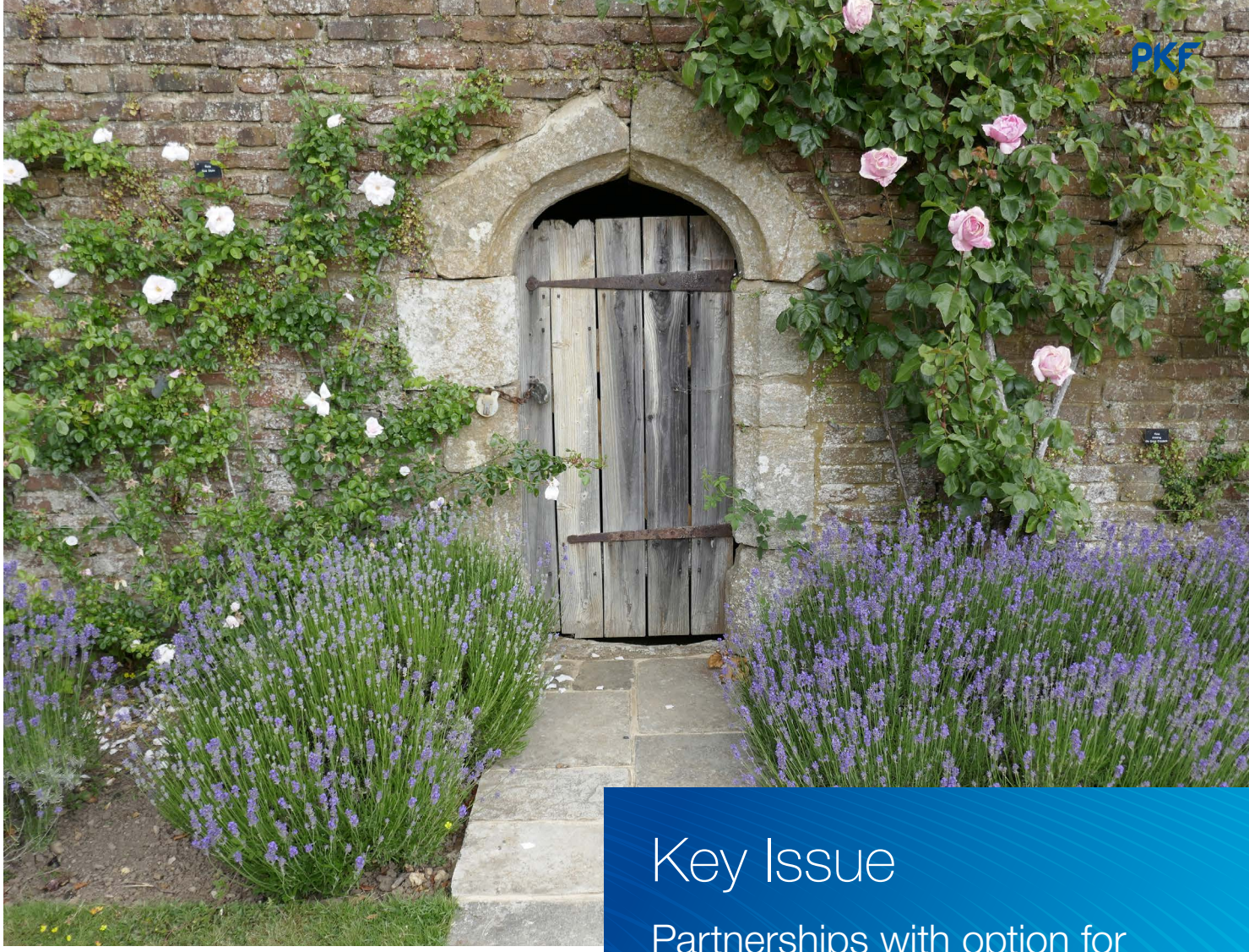
In the third report in the Tax section, we discuss important changes resulting from the **Third Coronavirus Tax-Related Assistance Act**; the main focus is on **extended loss carry-backs** where, potentially, action needs to be taken by 17.4.2021. The tax-related coronavirus measures have been flanked by a measure to boost digitalisation, which we present in the fourth report, namely, **instantly writing off computer hardware and software** in the year when they were purchased; this constitutes not only a tax break but also a simplification of the accounting process. Subsequently, we report on a **relaxation of VAT rules** on **in-kind donations** to facilitate stock clearance.

In the Accounting & Finance section, we have worked through the complex issue of the portfolio management instruments of **carve-outs and spin-offs**; these were recently used to realise the IPO of Siemens Energy AG, which was subsequently admitted to the DAX index. The first part of our series of articles deals with the fundamental economic considerations and the concept of the carve-out. In the May issue of our newsletter we will discuss, in particular, the influencing factors that determine the successful practical application of the carve-out and spin-off instruments.

In the Legal section we kick off with a discussion of the most important points of the **legislation to Strengthen Germany as a Hub for Investment Funds** that, above all, should benefit start-ups. In the second article we provide an **update** on the latest and controversial rulings on whether or not, as well as the conditions under which, **rent reductions** are permitted in the event of officially ordered closures.

With our best wishes for an interesting read.

Your Team at PKF



Key Issue

Partnerships with option for corporation tax – Draft legislation has been put forward

Contents

TAX

WP/StB [German public auditor/ tax consultant] Daniel Scheffbuch

Partnerships with option for corporation tax – Draft legislation has been put forward

The Federal Government presented a draft Act on the Modernisation of Corporation Tax Law on 17.3.2021. This also aims to internationalise corporation tax law. The focus here is on the introduction of an option for professional partnerships (*Personenhandelsgesellschaften,* a German type of professional corporation) and partnership organisations to be treated as corporations for tax purposes as of 1.1.2022.

1. An overview of the new regulations

The intention behind the legislation is to considerably enhance the fiscal environment for medium-sized professional partnerships and family enterprises and to further internationalise corporation tax law. The following new rules, in particular, serve this purpose.

- The introduction of an option for professional partnerships and partnership organisations to be treated as corporations for tax purposes (Section 1a Corporation Tax Act *[Körperschaftsteuergesetz, KStG]*).
- The globalisation of the sections of the Reorganisation Tax Act *[Umwandlungssteuergesetz, UmwStG]* that are relevant for the reorganisation of corporations (Section 1 UmwStG, Section 12(2),(3) KStG).
- The scrapping of adjustment items for intergroup overpayments and underpayments of profit transfers – due to pre-consolidation differences – (Sections 14 and 27 KStG) and, instead, treating these differences as (non-taxable) contributions or repayments of capital.
- Abolition of the non-deductibility rule for declines in profit due to currency fluctuations incurred in connection with shareholder loans (Section 8b(3) KStG).

In the next editions of the PKF newsletter we will provide greater details on all the areas where there are new rules. In the sections below, however, we have addressed solely the main features of the proposed statutory provisions on the option model.

2. The motivation for the option model

We have already discussed, in the 7/2020 issue of our PKF newsletter, the potential introduction of an option for partnerships to be treated as corporations for tax purposes and analysed the benefits of the effects of such an option. There was an announcement about the option model already in the package of measures to boost economic recovery, overcome the crisis and provide a future-focused stimulus that was passed by the German federal government on 3.6.2020; however, this was then not included in the 2nd Coronavirus Tax-Related Assistance Act.

The option model dates back to the so-called Brühl recommendations on reforming business taxation, in 1999. In the meanwhile, there has indeed been a convergence between the overall tax burdens of corporations and partnership members, nevertheless, there are considerable differences in terms of the system and the procedure of taxation. These relate, in particular, to the special business assets as well as the supplementary partner tax accounts of the members of a partnership. In an international context these particularities of German tax law are largely unknown.

3. Core elements of the provisions on the option model

(1) Treated as a corporation – The option model allows professional partnerships (*KG* [German limited partnership], *oHG* [German ordinary partnership] and comparable foreign companies) and partnership organisations as well as their partner members the possibility of being treated as a corporation and its non-personally liable shareholders for income tax purposes and, consequently, also from a procedural perspective.

(2) Exercised by filing an application – The option to be treated as a corporation for tax purposes can be exercised by filing an irrevocable application from the partners involved. The application has to be filed prior to the start of the financial year when taxation in accordance with KStG is supposed to happen. There are no plans for allowing the option to be exercised retroactively. The application would have a direct effect on the taxation of all the partners. Opting for corporation tax would require a resolution adopted by a majority of the partners of, at least, three-quarters of the votes cast.

(3) Consequences for taxation – As a result of exercising the option, the organisation will be treated as a corporation for tax purposes both substantively and procedurally; its partners will be classified as non-personally liable shareholders in a corporation. Consequently, all the provisions of, in particular, the KStG, EStG, the Reorganisation Tax Act, the Investment Tax Act and the Foreign Transaction Tax Act that relate to corporations will apply.

Please note: Exercising the option would however not alter the fact that an organisation that has to be "treated as a corporation" for income tax purposes would nevertheless still be a partnership under civil law.

(4) Change of legal form and tax neutrality – Transitioning to corporation tax would be deemed to be a change of legal form within the meaning of the Reorganisation Tax Act. To achieve tax neutrality no business assets that are essential for operations may be retained. This means that special business assets that are necessary for business operations likewise would have to be contributed.

(5) Civil law – Since, under civil law, the organisation will continue to exist as a professional partnership or partnership organisation then, unlike a corporation, it will not have nominal capital. The equity that has to be shown in the tax accounts will be recognised in total in the contribution account for tax purposes. Liabilities owed to a partner that are shown in a variable partner account will not be included in equity. The persons authorised to represent the organisation in accordance with commercial law or a partnership agreement will be regarded as the legal representatives of the partnership that has exercised the option.

(6) Taxation of the partners – A holding in a partnership that exercised the option will be deemed to be a shareholding in a corporation. Instead of commercial income the partners will now generate investment income from dividends/withdrawals that will be treated as income from capital assets. Furthermore,

- interest for partners' loans will lead to income from capital assets,
- remuneration for work to income from employment and
- rental and lease income to income from letting and leasing.

Please note: There are no plans for allowing an equivalent option to be exercised by sole traders.

RA/FAStR [German lawyer/Specialist German tax lawyer] Ralf Lüdeke

BREXIT – Customs challenges and complying with rules of origin requirements

Following the end of the Brexit transition period, the United Kingdom (UK) officially ceased to be a part of the EU at the beginning of 2021. While the VAT implications 'solely' relate to the current classification that is now applied to the UK, namely, a third country (previously Community territory), nevertheless, there are customs challenges that have to be taken into consideration. The focus here is on the interpretation of the procedural rules and the rules of origin requirements in the TCA.

1. Trade and Cooperation Agreement (TCA)

The Trade and Cooperation Agreement (TCA) between the EU and the UK has been applicable since 1.1.2021. The UK and the EU are third countries in each case. Consequently, since the beginning of 2021, customs declarations generally have to be submitted for exchanges of goods between the EU and the UK. Preferential customs treatment for imports into the EU from the UK (and vice versa) are granted only under specific conditions.

Please note: While Northern Ireland is part of the UK, nevertheless, it is treated as an EU member for customs purposes. That is why, under an additional agreement, movements of goods between the EU and Northern Ireland are regarded as goods traffic within the EU.

2. Rules of origin

Tariff reductions or exemptions from customs duties are only possible in the case of products originating from the territories of the parties to the agreement. In order to be able to claim preferential zero tariff rates, the so-called preferential origin of the product concerned has to be in the exporting country of the EU or the UK – as described in the rules of origin requirements and product-specific rules of origin in the TCA. The goods will then be deemed to be so-called 'originating products'.

Please note: A product does not originate in the EU if it was imported into the EU. In fact, it will be necessary to check whether or not, according to the preferential rules of origin, it is a product originating in the EU.

Determining the preferential origin is regulated in the Annexes to the TCA (see Chapter 2 and Annex ORIG-2). In order to be able to apply the preferential rules of origin, or to calculate a potential tariff rate, a product would have to be classified. If the product does not satisfy the preferential rules of origin requirements, or if it is not possible to demonstrate this then customs duties will be charged.

3. Proof of origin

3.1 Requirements

When importing into the EU from the UK (and vice versa) at preferential tariff rates the importers have to explicitly declare that they are able to demonstrate that the goods are of preferential origin. Zero tariff rates may only be claimed if one of the following two conditions has been satisfied:

- the importer has a declaration of the origin (so-called DOO) of the product that was issued by the exporter (code U116), or
- Importer's Knowledge about the origin of the goods exists (code U117).

3.2 Declaration of origin (so-called DOO)

The following provisions shall apply for declarations of origin (Annex ORIG-4 TCA):

(1) Issuing a DOO – Any exporter may issue a Declaration of Origin for exports from the EU to the UK if the value of the consignment is €6,000 (currently £5,700) or lower. If the value is higher then the EU exporter has to be a Registered Exporter (REX) and provide the respective number on the declaration.

(2) EORI number – For exports from the UK into the EU, regardless of the value of the consignment, an exporter will have to provide its EORI number on each declaration to EU customers.

(3) Written form requirement – The declaration of origin has to be submitted on an invoice or other commercial document and the originating product has to be described so precisely there that it is possible to identify it. Providing the information on a consignment note is not allowed.

(4) Validity period – A declaration of origin for imports

into the UK will be valid for two years from the date of its issue and 12 months for imports into the EU.

3.3 Importer's Knowledge

If the condition of 'Importer's Knowledge' has been satisfied then the exporter or manufacturer does not have to submit a DOO. This makes it possible for the importer to claim preferential tariff treatment based on information that it has received demonstrating that the imported product satisfies the requirements for obtaining originating status.

Please note: This documentary evidence has to be in the possession of the importer and be available in the event of customs audits. The importer has to have reliable information and the appropriate documentary evidence. If, in a subsequent review, it is not possible to verify the originating status then the third country tariff rate will apply. There would be no rectification possibility (we believe this is disputable). A refund would only be possible within three years if no application was made.

3.4 Supplier's declaration

Irrespective of whether the preferential tariff rates are claimed on the basis of Importer's Knowledge or on the basis of a DOO, it has to be generally possible to produce suppliers' declarations to demonstrate preferential origin in the EU or in the UK, i.e., during a customs audit it will be necessary to demonstrate where the individual components of the product originate from. This will not have to be presented during a transitional period lasting until the end of 2021. The importer must nevertheless be certain that the goods comply with the rules of origin requirements.

Please note: Importers have to make sure that they subsequently receive the suppliers' declarations. Conversely, exporters have to ensure that their suppliers have provided them with the suppliers' declarations by 1.1.2022. If EU-based exporters are not in possession of the suppliers' declarations by 1.1.2022 then they will have to notify the importers of this by 31.1.2022.

4. Remission or repayment of duties in the absence of an application

In the event of a failure to file an application for preferential treatment when importing goods then the remission or repayment of duties would be deemed applicable under the following conditions:

- application filed within three years after the date of the import,
- importer provides DOO or demonstrates the presence of its knowledge,
- the product would have had to be viewed as an originating product when it was imported as well as
- fulfilment of other requirements in the chapter on origin in the TCA.

5. Exception – Low value

No duty will not be charged on low-value consignments worth less than £135 that are imported into the UK. The same will apply for consignments with a value of less than €150 that are imported into the EU. Import VAT will however be charged by both sides.

6. Extension of transition period for UK imports

Following an extension, by the British government, of the deadline for customs checks on UK imports to 1.7.2021 on account of supply shortages, importers were initially able to 'log' the imports and subsequently complete the actual customs declaration. On 11.3.2021, this deadline was extended so that customs declarations for all UK imports will not have to be immediately completed and the import duties immediately paid prior to 1.1.2022. By contrast, the EU border agencies have not been so generous. They insist on declarations and goods checks.

Summary

A review of suppliers and customer relationships is imperative. UK suppliers or UK customers are now third country suppliers and third country customers. Besides checking the INCOTERMS, it is necessary to clarify, for example, who will assume responsibility for the transport, the goods insurance, the export declaration or the import declaration. The invoicing process needs to be reorganised accordingly to take account of the features and contents of a third country transaction.

WP/StB [German public auditor/ tax consultant] Daniel Scheffbuch/ Luca Gallus

Important changes resulting from the Third Coronavirus Tax-Related Assistance Act

On 5.3.2021, the *Bundesrat* (upper house of German parliament) passed the Third Coronavirus Tax-Related Assistance Act. A key aspect in terms of the content of the legislation is a further increase in the tax loss carry-back; if tax assessment notices for 2019 are already final and unappealable then urgent action is needed by 17.4.2021.

1. Tax loss carry-back

The Second Coronavirus Tax-Related Assistance Act had already provided for an increase in the tax loss carry-backs for 2020 and 2021 from €1 m or €2 m (in the case of a joint assessment for spouses) to €5 m or €10 m. Now, as a result of the Third Coronavirus Tax-Related Assistance Act, it will even be possible to carry back an amount of up to €10 m or, in the case of a joint assessment for spouses, €20 m to 2019 and offset it there against positive income. This provision will also apply analogously for corporations that will likewise be able to claim the increased loss carry-back of €10 m. According to the current status, the previous legal text relating to tax loss carry-backs will have to be applied again from 2022.

If the tax return for 2019 has not yet been submitted or if the tax assessment notice is not yet final and unappealable then a first-time or amended request can be made for the provisional loss carry-back to be taken into consideration. In the case of tax assessment notices for 2019 that are final and unappealable, it is now possible, within one month following the publication of the Third Coronavirus Tax-Related Assistance Act – thus, until 17.4.2021 – to make a request for the provisional loss carry-back for 2020 to be taken into consideration or to request that the loss carry-back be widened accordingly. The tax assessment notice for 2019 may be altered in this respect.

Lawmakers have also extended the provision on the provisional loss carry-back. It will thus be possible to take a provisional loss carry-back from 2021 into consideration in the tax assessment for 2020. The requirement for this is that the prepayments for 2021 had been reduced to €0.

2. VAT on restaurant and catering services

The reduced VAT rate of 7% applicable for restaurant and catering services that are provided will be extended beyond

the limit of 30.6.2021 until 31.12.2022. As previously, this does not apply to the sale of drinks.

3. Coronavirus benefit payments

After the one-off child benefit payments that were already made in 2020, there will be another such benefit payment. There will be a one-off payment in the amount of €150 for each child who is eligible for child benefit in May 2021, probably in the month of May in 2021. The one-off payment will be made automatically – there will be no need to apply for it. Moreover, it will not count towards social welfare benefits and will not reduce maintenance payments.

4. Bridging Assistance III

Advance payments will continue to be made within the scope of Bridging Assistance III. The level of payments will be determined in accordance with the so-called eligible fixed costs. Moreover, there will be direct support for building measures to implement hygiene strategies as well as investments in digitalisation and the re-start assistance for the solo self-employed will be enhanced.

StBin [German tax consultant] Heike Bunselmeyer

Shorter useful life of computer hardware and software

Assets such as computers and software form the core of digitalisation and are subject to ever faster change on account of technical advances. The Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* resolved to significantly reduce the useful life of such assets in order to create tax incentives to encourage further digitalisation.

1. Tax implications of the reduction in the useful life

The average useful life of assets constitutes the basis for linear tax depreciation (in German: *Absetzung für Abnutzung, AfA*). According to the official German tax depreciation tables, computer hardware and software could only be depreciated or amortised over three years.

With a view to stimulating the economy and boosting digitalisation, the BMF, in its circular from 26.2.2021, opened up the possibility of recognising a useful life of just one year for computer hardware and software. Accordingly, in the context of an instant asset write-off, the full amount of the purchase costs of such assets may already be deducted in the year of acquisition as business expenses or as work-related costs.

Please note: The reduction in the useful life is an option. Depreciation or amortisation over a period of three years is still possible.

2. Assets covered by this option

The BMF circular includes a detailed list of assets that are covered by the terms 'computer hardware' and 'software'. 'Computer hardware' also includes, in particular, peripheral devices, here primarily devices that are used for the input and output of data (such as, e.g., printers and screens).

Please note: Up to now, instantly writing off peripheral devices as low-value assets had been rejected as they could not be used on a standalone basis. The criterion of use on a standalone basis now no longer has to be met.

Cash register systems may also be included in the change to the useful. What matters here is that the cash register has to be computer-based (non-electronic cash registers are not covered by the option).

The term 'software' covers operating and user software for data input and processing. This includes, besides standard applications, also software that has been customised for users, such as, ERP software, software for merchandise management systems or other application software for business administration or process control.

3. Temporal scope of application

Instant asset write-off will be used for the first time for financial years ending after 31.12.2020. A full write-off will also be possible in 2021 for the residual book values of assets that were purchased in earlier financial years. As of the 2021 assessment period, the same will apply to assets held as private assets that are used to generate income.

Coronavirus-induced suspension of VAT on in-kind donations

In-kind donations are generally subject to VAT if the items had been previously purchased with input tax deductions. It is therefore not uncommon that returned goods, which cannot be easily reused, are more likely to be disposed of than donated. Now, in the context of the coronavirus pandemic, VAT on in-kind donations from retailers will be suspended under specific conditions.

1. New special rules for in-kind donations

In view of the exceptional situation for retailers as a result of the coronavirus pandemic, which has meant that typical sales after in-store personal consultations were not allowed any more, special rules for in-kind donations have been introduced for the period from 1.3.2020 to 31.12.2021. Now, two Federal Ministry of Finance (*Bundesministerium der Finanzen, BMF*) circulars from 18.3.2021 (references: III C 2 – S 7109/19/10002 :001, document no. 2021/0251308 and 2021/0251343) have set out the suspension of VAT on in-kind donations, or its reduction to zero in the assessment base, for retailers that have suffered a direct adverse economic impact, which is not insignificant, as a result of the coronavirus crisis. The prerequisite for this is that, during the above-mentioned period, the donation accrues or has accrued to a tax-privileged organisation.

2. Extending a common practice

The BMF circular has extended a common practice for in-kind donations of food. In the case of food and non-food items with a best-before date (e.g., drugstore products or pet food) it should be presumed that the goods are objectively worthless if their best-before dates are about to expire. Consequently, the VAT assessment base, which is determined by the notional purchase price when the donation was made (replacement costs), is reduced to €0.

3. Coronavirus-induced equitable measures

For retailers with goods that are no longer marketable, or only to a very limited extent, (e.g., seasonal goods) the rules are considered to be equitable measures as a consequence of the coronavirus pandemic. The tax on ceded assets will be waived in the case of donated goods that still have an objective value in €. However, the assessment base will not be reduced to €0 in this way. Instead, a tax claim will still arise and will have to be determined (and actually also has to be reported). If the conditions in the BMF circular have been met then the fiscal authority will, for equitable reasons, waive the claim arising from the tax liability.

ACCOUNTING & FINANCE

WPin [German public auditor] Julia Hörl / Benedict Heidbüchel

Carve-outs – Active portfolio management through the demerger of a business division

Part I – Divestitures in turbulent markets

Carve-out transactions play an increasingly important role in the context of successful structuring of M&A activities, for example, as a preparatory step for spin-offs. Furthermore, demergers of groups also act, among other things, as a major driver for IPOs at the stock exchange. The first part in our series of articles begins by examining the current developments in the M&A market and then discusses the fundamental economic rationale for carve-outs. A closer analysis of the spin-off and equity carve-out forms of demergers as well as a detailed look at the key success factors for business divestitures in volatile market conditions will then follow in the May edition of our newsletter.

1. On the economics of divestitures

The maximisation of shareholder value is largely used as

a dominant objective in finance and capital market theories. In (German-speaking) practice, too, for many years now there has been a considerable shift towards aligning with investor interest when making business decisions. In terms of the active management or streamlining of a portfolio, this frequently manifests itself specifically in a functional as well as a legal demerger of a (not necessarily) loss-making business division.

A development can be observed here that draws on the economic rationale of the sum-of-the-parts theory. According to this, 'activist investors' attempt to realign diversified industrial conglomerates through restructuring; in such cases, the intention is to realise the 'break-up value' as well as to reduce or eliminate the 'conglomerate discount'. In this connection, the break-up value is understood to be the value creation contributions that would be released through divestitures. The conglomerate discount can be calculated by comparing the company's market capitalisation with the so-called intrinsic (true) value of the business divisions and it can be eliminated by means of the break-up value.

The intrinsic value of an enterprise or an asset is derived from its ability to generate cash flows (in the future). In this case, the value of an enterprise is determined on the basis of

- an analysis of its fundamentals,
- the absolute levels and growth of cash flows as well as
- the risk that has to be taken in order to achieve these.

This is compared with the current market capitalisation, which is defined as the value of all the shares. Here, the stock quote or the share price is generally derived from supply and demand and will thus always depend on the prevailing market sentiment, As a general rule, a – not uncommonly considerable – difference will arise here between the market capitalisation and the intrinsic value of the enterprise.

'Activist investors' are investors who initiate transformation processes by challenging the strategic orientation of the respective company; frequently, this is also contrary to the stated intent of the current management. Here, companies that exhibit a value gap – which arises from the difference between the market capitalisation and the intrinsic value – will be classified as being undervalued.

2. Achieving objectives through carve-outs

The primary objectives of a divestiture worth mentioning are:

- to focus on the core business, or
- to strategically (re-)orient the business portfolio because of changes in the market of the selling company, or
- to raise funds in the short term.

Increasing shareholder value – which we mentioned at the beginning – is an aim that is common to all these motives. To this end, a carve-out and a subsequent divestiture could be a sensible course of action if, for

example, a business division does not generate the return on capital employed required by the owners or the executive board.

Practical example – One of the biggest M&A transactions in recent years was the carve-out and subsequent sale of the elevator division of Thyssen-Krupp AG to a private equity consortium.

Such transactions show that individual business divisions are more valuable by themselves, or are more highly rated than can be inferred from an overall perspective; this also means in particular that, in such cases, because of rating aspects the sum of the parts or of the business divisions is usually greater than the value of the overall group.

Conclusion and Outlook

In a tense economic climate, pursuing divestitures makes it possible not only to generate liquid funds but also to bring about a strategic reorientation of corporate structures. In business practice, carve-outs provide an instrument that is particularly suited to revitalise business divisions in different environments. In the next PKF newsletter, we will take a detailed look at the key success factors for the practical implementation of the particularly relevant forms of demergers, namely, spin-offs and equity carve-outs.

LEGAL

The Fund Location Act – Draft law to support start-ups and SMEs

On 20.1.2021, the German government put forward draft legislation with the aim of making Germany a more competitive and attractive financial centre and hub for investment funds. To this end, there are plans for supervisory but also tax measures such as, among other things, increasing the maximum tax-exempt amount for employee share ownership plans (ESOPs).

1. VAT exemption for venture capital funds

According to the current national regulations, VAT exemption extends to investment funds within the meaning of the UCITS Directive and to the management of such alternative investment funds (AIF) that are subject to the same conditions of competition. Up to now, management services provided to venture capital funds in Germany have been VATable; this has been a key disadvantage for Germany compared to other European locations. That is why the VAT exemption for investment fund management will be extended to venture capital fund management.

2. Strengthening ESOPs

Unlike profit sharing, ESOPs are rather rare in Germany. An ESOP is understood to mean a plan under which a company's employees own shares in that company and where this is on the basis of a contract, usually, for the long term. To strengthen the appeal of such plans there is an intention to increase the annual maximum tax-exempt amount for capital participations from €360 to €720 with effect from 1.7.2021.

Here, a particular focus will be placed on start-up enterprises where equity participation for employees is used relatively frequently. That is why there will be legal provisions to allow employees at start-ups (but generally at small and medium-sized enterprises, too) to defer the payment of tax on the gains from the transfer of capital participations in the employer's company if employees wish to do so. Tax will usually only be paid when the employee shares are sold, although, at the very latest, this would be after ten years, or when the employee switches employers. Here, the taxable remuneration will fall within the scope of the rate reduction in the form of the so-called 'one fifth rule' (a form of top slicing relief) if at least three years have elapsed since the transfer of the capital participation. The aim is to apply the rate reduction already in the payroll tax deduction system on condition that the capital participations have been granted in addition to remuneration due in any case.

Please note: Salary sacrifices would consequently not be accorded tax privileges.

RA [German lawyer] Andy Weichler

On the admissibility of coronavirus-induced rent reductions

In recent decisions on commercial lease agreements, two Higher Regional Courts *(Oberlandesgericht, OLG)* simultaneously ruled on adjustments made to agreements because of the coronavirus pandemic within the context of Section 313 of the Civil Code *(Bürgerliches Gesetzbuch, BGB)*; however, the two courts came to different conclusions.

In their rulings from 24.2.2021, the Karlsruhe OLG (case reference: 7 U 109/20) and the Dresden OLG (case reference: 5 U 1782/20) arrived at different views of the preconditions for making adjustments to agreements in the form of rent reductions. The decision of the Dresden OLG was based on the assumption that for the period when a textile clothing store was officially ordered to close it only owed the amount of rent that had been reduced by half; however, the Karlsruhe OLG took the opposite view. Judges at the Karlsruhe OLG assumed that the tenant had not provided enough information on whether or not it had been possible to sufficiently offset the monthly declines in sales through online sales, short-time working or savings on expenditure. Interestingly, in both cases the textile clothing markets affected belonged to the same business chain.

These rulings illustrate that it is currently not possible to draw definitive conclusions as to which conditions would have to be satisfied so that the right to make contractual adjustments to a commercial lease agreement in accordance with Section 313 BGB would arise in the event of an official order to close. There will be no clarity in this respect until the Federal Court of Justice (Bundesgerichtshof, BGH) gives a ruling. As both rulings permitted appeals, it is possible that the BGH will very soon be able to take an in-depth look at this issue.

Recommendation

In the meantime, we would recommend that you seek dialogue with your landlord and, with reference to the Dresden OLG's ruling, make your rental payments on the proviso that they could be refunded.

Foreign shareholdings – Notification obligations

The Fiscal Code *(Abgabenordnung, AO)* contains a reporting obligation on the basis of which German taxpayers have to notify their competent tax offices of particular cross-border transactions. This includes, among other things, the founding and acquisition of businesses and permanent establishments abroad as well as shareholdings in foreign partnerships and corporations.

However, there are de minimis thresholds for reporting obligations relating to corporate bodies, associations of persons and pools of assets. Accordingly, the tax office only needs to be notified if

- the stake in the share capital or in the assets of the foreign company or the pool of assets is at least 10%, or
- if the acquisition costs of all the shareholdings come to more than €150,000.

Since there had been a need for clarification in respect of Section 138(2) AO, the Federal Ministry of Finance commented on this in a circular from 28.12.2020 (reference: IV B 5 – S 0301/19/10009 :001). Here, the Ministry clarified that the reporting obligation should also apply to indirect shareholdings. However, the notification requirement applies only to those shareholdings that German taxpayers themselves have acquired for payment or without payment. The notification requirement generally comes into effect not only when there are changes of ownership but also in the event of the sale of a shareholding.

The notifications have to be submitted together with the income tax return, corporation tax return, or the statement illustrating the determination of the bases for tax assessment for the taxable period when the situations to be communicated were achieved, however, at the latest after a period of 14 months after the end of this taxable period.

Please note: This is a non-extendible deadline since it is neither an officially specified time limit nor a deadline for submitting a tax return.

Employment relationship between spouses has to stand up to an arm's length comparison

Where employment contracts are between close relatives the salary payments can be deducted as business expenses if they comply with the arm's length principle and are also actually 'put into practice'. In a recent ruling, the Federal Fiscal Court *(Bundesfinanzhof, BFH)* expressed its views on the arm's length principle.

In the opinion of the BFH judges, the crucial point is whether or not the allocation of the opportunities and the risks complies with the arm's length principle. In the event of an unequal allocation the recognition for tax purposes may be withdrawn so that, among other things, the business expense deduction for salary payments would be lost. The facts of the case relating to the BFH ruling from 28.10.2020 (case reference: X R 1/19) were that a businessman had hired his wife as an office worker and, besides an employment contract, had concluded a supplementary agreement for a working time credit model. This model envisaged that the allocation of remuneration components to the credit balance would not trigger social security contributions and payroll tax since no remuneration would have been paid to the employee.

Specifically, the agreement included a provision that the wife would be able to use an unlimited amount of her remuneration to build up working time credit in order to, among other things, retire early, reduce her working hours or take a 'block of free time' off. The intention here was for most of the gross remuneration for the wife of the businessman to be allocated to the working time account. The profit-reducing provision that was set up for the working time credit was not recognised by the tax office.

The BFH judges adopted the opinion of the tax office. It was doubtful that the agreement would stand up to an arm's length comparison and thus the concomitant likely imbalance in the allocation of opportunities and risks would be to the detriment of the employer spouse.

Please note: This assessment was based on the fact that the wife was able to save up an unlimited amount of working time credit and that, here, the duration, point in time and frequency of phases when she was not obliged to work could be selected almost arbitrarily.

AND FINALLY...

„You cannot talk to people successfully if they think you are not interested in what they have to say or you have no respect for them.“

Larry King, 19.11.1933 – 23.11.2021, US American journalist and talk show host

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PKF Deutschland GmbH Wirtschaftsprüfungsgesellschaft

EUREF-Campus 10/11 | 10829 Berlin | Tel. +49 30 306 907 - 0 | www.pkf.de

Please send any enquiries and comments to: pkf-nachrichten@pkf.de