Accountants &
business advisers

PKF newsletter 05|17

Editorial

Dear Readers,

Cum/ex trades and **dividend stripping** are more and more frequently the subject of legal disputes. In the Focus section we show that, for a long time, lawmakers stood idly by watching an unsuccessful law and, now, the tax authorities are attempting to claw back part of the € 12 bn booty, but they are taking a questionable approach.

The lawmakers have apparently overshot the mark by placing restrictions on the **affiliation privilege** because, now, due to a legislative change, some **financial companies** will enjoy tax relief. In the second contribution in the 'Tax' section, you can then find out when, in the view of the Federal Ministry of Finance, a **licensing obligation** for **trademarks** in an international group of companies is deemed to exist. The third report provides advice on how the analysis of the accounting treatment of **rental expenses** can lead to a **reduction in trade tax**.

The focus of the 'Legal' section is the **Flexible Pensions Act** that has ushered in various new rules that will have considerable effects on employees and employers. As the name of the act already suggests, it will now be possible to have a more flexible transition from working life into retirement than was previously the case. In the other reports you can read about the conditions under which it is possible to **limit liability internally** when there are several **managing directors** and see that disputes do not always have to be **resolved** in court.

In the 'Accounting' section, we have produced a review for you of our initial practical experiences with the tax authorities' principles for the **retention of electronic documents**.

Virtual financial participation programmes are an alternative for companies that are not able to provide their employees with a direct investment in corporate equity. Under 'Corporate Finance' we present the key points of this instrument, which should be of interest for young companies in particular.

We hope that you will find the information in this edition to be interesting.

Your Team at
PKF

Contents

FOCUS

Cum/ex trades – the tax authorities would like their money back. Will they achieve this?

Cum/ex trades or dividend stripping made it possible for multiple rebates on capital gains tax that was paid only once. Although this tax loophole had been known about for a long time it was not closed until 2012. The upshot of the new legal provision is that capital gains tax that has been withheld can be credited if it has also been transferred beforehand to the local tax office. The tax authorities are trying to collect an estimated € 12 billion in tax that has been lost. Currently, tax investigators are targeting more aggressively those who were previously involved in these tax models.

1. Description of the model

Cum/ex trades are share transactions made around the dividend record date. In the course of these, in accordance with the law of obligations, the transfer of shares with an entitlement to the dividend ("cum") occurs shortly before the dividend record date and the in rem delivery without the entitlement ("ex") shortly after the dividend record date. The model involves the following steps:

- Prior to the dividend record date, short sellers sell shares that they do not even have ("shorting") to buyers but only have to deliver the securities shortly before the dividend payout. In the case of cum/ex trades with short selling, the seller (short seller) is not the owner of the shares.
- The beneficial and legal owner, under civil law, of the shares (a third party) receives the dividend on the dividend record date.
- After the dividend record date, the short seller obtains the shares from the third party and delivers these to the buyer. In addition, the buyer receives a payment from the short seller in the amount of the dividend reduced by the value of the capital gains tax (dividend compensation payment).

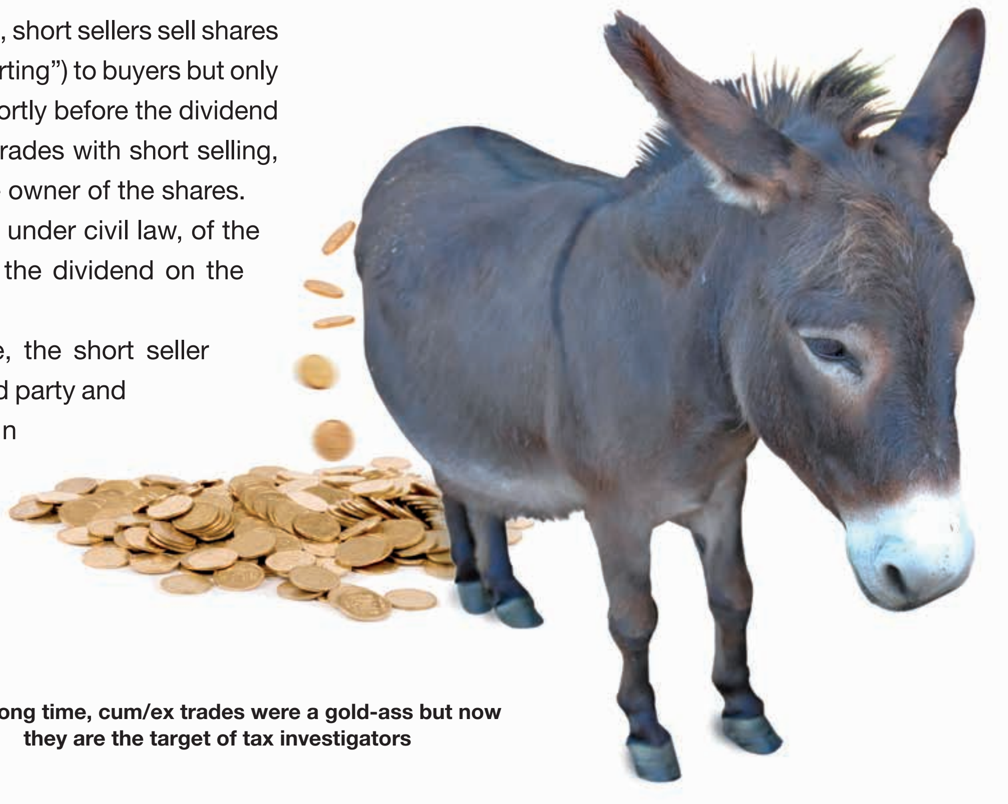
The joint stock company (*Aktiengesellschaft*, AG) making the dividend payout was obliged to withhold and pay the capital gains tax. In the case of cum/ex trades, tax certificates are issued twice:

- once by the custodian bank of the owner on the date of the payout (a third party),
- and again by the custodian bank of the buyer.

The time gap between the payment of the tax and the certification of the capital gains tax made it possible that capital gains tax that had been withheld once was certified several times and credited. As a result there was a loss in tax revenues in the billions. The question that arises is whether or not, under tax law, the buyer was legally entitled to credit capital gains tax.

2. Developments in the legal situation

Up to 2007, under Section 36(2) no. 2 of the German Income Tax Act (*Einkommenssteuergesetz*, EStG) (old version), buyers were allowed to credit certified capi-



For a long time, cum/ex trades were a gold-ass but now they are the target of tax investigators

tal gains tax against dividend income if the shares were allocated to them on the date of the profit distribution resolution. As the basis of this allocation was unclear, it was possible to issue a tax certificate to the buyers that they used in order to credit the capital gains tax. Up to 2007, under the applicable regulations, it was not important for the capital gains tax that had been withheld to have actually been transferred to the local tax office and if the capital gains tax had not been withheld on behalf of the buyers.

According to Section 20(1) no. 1 clause 4 of the EStG, which has been applicable as of 2007, dividend compensation payments are an explicit part of income from capital assets and allow capital gains tax to be credited. The allocation of the shares to the buyer was no longer a condition for this. The transfer of capital gains tax by domestic (German) custodian banks was set up and capital gains tax transfers and the tax credits matched each other. However, foreign custodian banks were not obliged to transfer the capital gains tax and this regulatory loophole, together with the involvement of foreign banks, preserved the double crediting in the case of cum-ex trades.

It is only with the UCITS IV transposition law, since 1.1.2012, that it has been possible to efficiently prevent tax revenue losses through the cum/ex model. The new legal rules shifted the obligation to withhold tax. The AG making the pay-out now transfers the gross dividend to the paying agent. The obligation to withhold tax lies with the domestic institution that credits and pays out the capital gains. If the crediting or payment is carried out by a foreign agent then the obligation to withhold tax lies with the last domestic (German) agent that transferred the respective amounts to the foreign agent.

» **Please note:** Since February 2016, a committee made up of the German parliamentary groups of the Greens and the Left has been focused on clarifying cum/ex trades. Up to now, there have been over 40 meetings. The aim is to discuss the final report in the Bundestag (lower house of German parliament) prior to the elections in September.

3. The tax authorities are working to limit the losses

In a circular from 5.5.2009, the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) tried to limit the losses that had occurred by demanding evidence that there had been no detrimental agreement between the short seller and the buyer. In the specialist literature, the BMF has been accused of violating the principles of the separation of powers and the rule of law. Unsuccessful laws still have to be applied even if this results in a loss for the tax authorities.

The second concern of the tax authorities is the beneficial ownership of the shares that is agreed upon with the buyer. With reference to Section 20(5) of the EStG (formerly para. 2a), in the absence of the allocation of the shares, the buyer has no dividend income with an entitlement to credit the tax that has been withheld. Furthermore, since 2007, the question has been whether the explicit provision for dividend compensation payments has made the assessment of beneficial ownership obsolete or was even rescinded if the model excluded the allocation of shares to the buyer. The Federal Fiscal Court (*Bundesfinanzhof*, BFH), in its ruling from 16.4.2014, stressed the relevance of beneficial ownership. The Hesse tax court, in its ruling from 10.2.2016, highlighted the obligation of the buyer to provide evidence that taxes have been withheld.

The initiation of criminal proceedings with the resulting extension of the limitation period for assessments in the case of tax evasion seems to the tax authorities to be an appropriate means for reopening final notices of assessments and refusing capital gains tax credits retroactively. For example, on 16.7.2015, the Cologne Regional Court ruled that in cum/ex transactions where there had been multiple rebates of capital gains tax but, however, it had only been transferred to the tax office once fulfils the elements of tax evasion. Accordingly, the objective element of tax evasion implies that when applying the capital gains tax credit the taxpayer provided incorrect information about facts related to tax collection. A subjective element should be presumed if the buyer acted at least with “dolus eventualis”, i.e. by having obtained a dividend compensation payment s/he condoningly accepted that no income would be generated in accordance with Section 20(1) no. 1of the EStG and, thus, would not be entitled to a rebate of, or a credit for, capital gains tax.

» **Recommendation:** Up to 2007, the legal situation was not clear. Short sellers who fear being accused of tax evasion should seek professional help at an early stage on how to protect themselves against these.

TAX

Tax relief for financial companies through the revision of Section 8b(7) of the German Corporation Tax Act

Who for: Credit institutions, financial services institutions and financial companies, in particular, holding and private equity companies.

Issue: Under certain conditions, the special rules in Section 8b (7) of the German Corporation Tax Act (*Körperschaftsteuergesetz*, KStG) do not permit taxpayers to apply the 95 % tax exemption for income and losses from investments (the so-called affiliation privilege). However, contrary to the legislators' intentions, in view of the broad interpretation of these special rules – which were intended for financial companies – pure holding and private equity companies have also been affected.

The BEPS Transposition Act, which was recently approved, corrects this overly broad interpretation and limits the rules to the original legislative intent. Through this revision the bank-specific focus of Section 8b (7) of the KStG has been restored. Accordingly, the provision is restricted to credit institutions, financial services institutions as well as financial companies in which a stated group holds more than 50 %. Moreover, the tax exemption would cease to apply to shares only if the shareholding, when it is acquired, is allocated to current assets

Company name or trademark – the added value is key

in the financial accounts (the so-called trading portfolio). Therefore, retroactively reassigning shareholdings from or to the trading portfolio is not relevant.

As a result, pure financial holding companies in groups of commercial companies will no longer be affected by this provision. Moreover, in the future, the purchase and quick sale of shareholdings at these companies will, once again, be subject to a tax exemption within the meaning of Section 8b of the KStG.

The use of names and trademarks in a corporate group

Who for: Group companies that provide the company name or the group's trademarks across borders to other group companies for their use.

Issue: In a circular from 7.4.2017, the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF) expressed its opinion on "The use of the name within a corporate group" ("*Namensnutzung im Konzern*"). This was preceded by a Federal Fiscal Court (*Bundesfinanzhof*, BFH) ruling on 21.1.2016. The criterion of eligibility for royalties has to be identified.

(1) Eligibility for royalties based on the merits – Eligibility criteria for such payments include managing a uniform company name, employing uniform company symbols as well as the right to use the trademark within a multinational group of companies or a multi-corporate enterprise if the owner of the name or the trademark (usually the group parent company) has the right or the actual possibility to exclude unrelated third parties from using the name or trademarks, or to refuse permission for outside third parties to use them. Registering a trademark leads to the owner having the sole right to use this trademark. If German trademark rights are infringed then the trademark owner can assert a claim for injunctive relief and/or damages. The same applies to unprotected know-how – a competitor can be excluded from using it, for example, through non-disclosure.

(2) Eligibility for royalties in terms of amount – A payment obligation can only be presumed, however, if, based on the right to use that has been granted on factual or legal grounds, users can also expect a commercial benefit irrespective of whether or not this benefit actually arises (ex-ante approach).

A group company that produces goods or provides services in the market and, in the course of this, uses intangible assets should, in principle, pay royalties accordingly that are calculated on the basis of the arm's length principle. Therefore, as a rule, the use is not chargeable:

- in the case of sales subsidiaries that market the group's products exclusively;
- in the case of production subsidiaries with cost-plus methods and that solely supply the owner (i.e. no third-party sales).

» **Recommendation:** On the basis of a **trademark benefit analysis** it is possible to determine the advantages that will probably arise and the expected commercial benefits. This could include, for example, the following questions:

- Does the trademark benefit depend on the respective product or the service and/or the group of buyers (end consumers or businesses)?
- Is the trademark an expression of reliability, technical quality and trust in certain features?
- Does the trademark serve to generate a quantity/price premium, to ensure customer loyalty, or to be a distinguishing criterion among customers?
- Is the trademark attached to products and/or used for advertising purposes?

» **More Information:** The full text of the BMF circular from 7.4.2017 (case reference: IV B 5 - S 1341/16 /10003) is available at www.bundesfinanzministierum.de and the BFH ruling from 21.1.2016 (case reference: I R 22/14) can be accessed at www.bundesfinanzhof.de. (German versions only).

Trade tax add-backs of rental amounts – Deduction of capitalised expenses

» **Who for:** Tradespeople who perform work or manufacture products with leased assets.

» **Issue:** Trade tax, as an impersonal tax, should treat equity-financed and debt-financed earnings equally. The net gain from rent and lease payments (the so-called financing share) should be subject to trade tax in some cases because it is generated in the enterprise. That is why prohibitions on the deduction of financing fees in the form of add-backs were created through a legislative package (Corporate Tax Reform Act or *Unternehmensteuerreform*, UntStRefG of 2008). In practice, the entire amounts posted to the respective accounts in the P&L are regularly added back. However, Section 8 no.1 of the Industry and Trade Tax Code (*Gewerbesteuerverordnung*, GewStG) only covers amounts that have actually reduced profits. The Federal Fiscal Court (*Bundesfinanzhof*, BFH), in it ruling from 30.4.2003 (case reference: I R 19/02) decided, with respect to the old legal situation, that interest that had arisen during the construction period of an asset, and which was included and capitalised in the production costs (PC) of the capital assets within fixed assets, should not be added back as long-term debt in the reporting period of the capitalisation, nor in the following reporting period, in which write-downs that reduce taxable profit are recognised. The tax authorities apply the principles of this ruling for add-backs, without any restrictions, also to current assets (see decrees issued by the German federal states from 2.7.2012, margin no. 2). Accordingly, on the balance sheet date, the rental amounts included in PC for capitalised "work in progress" should not be added back. Moreover, there are no add-backs in subsequent years either. Therefore, the add-backs are limited to work and services that will still be invoiced in the same year.

If the expenses are part of PC they constitute production overhead costs that are incurred as a surcharge that is added to direct labour costs, or as a special element of hourly machine rates in the valuation of inventories. If a precise calculation is only possible with a high input of resources that is deemed to be unreasonable then the capitalised amounts can be determined on the basis of an estimate as shown in the following example (amounts in €):

Sales revenues	10,000,000
Share of PC (here, assumed to be 75 %)	7,500,000
Change in inventories (PC)	500,000
Total output at PC	8,000,000
Inventory (work in progress)	3.000.000
Share of total output (in %)	37.5
Rental amounts for movable capital assets:	300,000
thereof production costs (here 100 %)	300,000
capitalised share (in %)	37.5
amount of reduction	112,500
obligatory add-back	187,500
Rental amounts for immovable capital assets:	800,000
thereof production costs (here 85 %)	680,000
capitalised share (in %)	37.5
amount of reduction	255,000
obligatory add-back	545,000

» **Recommendation:** When drawing up a trade tax return you should take into account the reduction of rent and lease payments by the capitalised amount (estimated if necessary).

LEGAL

Flexible Pensions Act – Flexibilisation of the transition from working life into retirement

The 'Act on the flexibilisation of the transition from working life into retirement, and the strengthening of prevention and rehabilitation in working life' (usually abbreviated in German to the Flexi-Rentengesetz) was passed by the Bundesrat (upper house of the German parliament) at the end of November 2016. The aim is to foster a smooth transition from working life into retirement. From the age of 63, employees will be given enhanced opportunities to combine part-time work with a partial pension. Moreover, employers who continue to employ staff beyond the statutory retirement age will be able to claim tax relief. The act came into force on 1.1.2017, although the provisions relating to supplementary income when drawing a partial pension will be applicable from 1.7.2017.

1. Objectives and key points

The effects for employees and employers will in particular arise from the following new rules:

- Enhanced opportunity to supplement a partial pension with a part-time job before you reach the statutory retirement age. It will be possible to combine a partial pension and supplementary income with each other flexibly and individually. In the case of pensions, the supplementary income will be taken into account variably on a full-year view.
- Those who took early retirement and are drawing a full old-age pension and have continued to work, in future, will be obliged to pay pension insurance to the full extent until they reach the statutory retirement age. As a consequence, however, the pension entitlement will go up.
- If somebody continues to work once they have reached the statutory retirement age then s/he will be able to waive the existing exemption from insurance in order to acquire further pension remuneration points and, therefore, be entitled to a higher pension from the statutory pension scheme.
- To compensate for reductions in pensions it will be possible to pay additional contributions into the pension scheme earlier and more flexibly than previously.
- New rules for prevention and rehabilitation will increase pension scheme benefits and old-age provision for farmers.
- Moreover, employing older staff will become more attractive as the separate employer's contribution to unemployment insurance that was hitherto incurred will cease to apply for five years for employees beyond the statutory retirement age.

2. Old supplementary income limit will apply until 30.6.2017

According to the regulations up to now, for pensioners who have not yet reached the statutory retirement age it has only been possible to a limited extent to earn supplementary income without having their pension entitlement reduced. The monthly supplementary income limit is € 450 and it is only possible to earn double this amount, i.e. € 900, twice in each calendar year. If the supplementary income limit is exceeded then the pension is reduced in steps down to two thirds, one half and a third of the full pension. The level of the pension reduction depends on the amount of the supplementary income. Here, specific supplementary income limits apply for the separate partial rent levels. These are calculated in accordance with the pensioner's personal income in the last three calendar years prior to the start of retirement. If the supplementary income exceeds a limit by even only one cent then the pension is reduced to the next lower level and, ultimately, down to zero.

Once they reach the statutory retirement age, pensioners' can earn unlimited amounts of supplementary income.

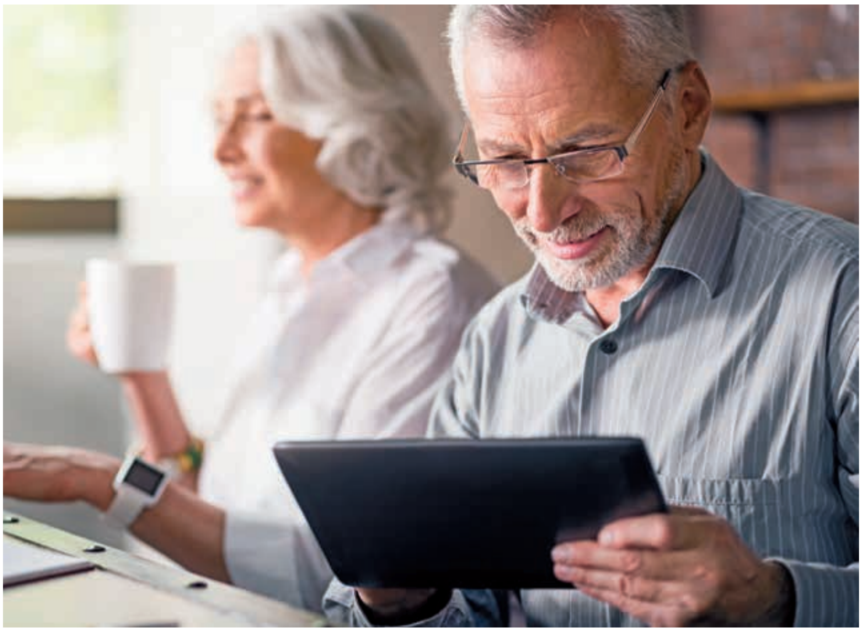
3. New supplementary income limit will apply from 1.7.2017

As of 1.7.2017, prior to reaching the statutory retirement age, pensioners will be able to earn a disregardable supplementary income of € 6,300 annually. The previous monthly limit of € 450 will be scrapped. The pension will now only be reduced and, thus, transformed into a partial pension if, based on a retroactive annual view (on 1.7. for the previous year), this new limit is exceeded.

Crediting the supplementary income against the pension will happen in three stages:

- Supplementary income of up to € 6,300 annually – not credited
- Supplementary income of more than € 6,300 annually – 40 % will be credited
- Supplementary income above the supplementary income cap level – 100 % will be credited

The “supplementary income cap” is the sum of the reduced pension and the supplementary income that exceeds the previous income (best income of the last 15 calendar years). The amount of the reduction will be calculated individually and there will no longer be a flat-rate reduction in stages.



Flexible pension – careful consideration should be given to the wide range of structuring variants

4. Determining the statutory retirement age

A distinction has to be made between the statutory retirement age and the age at which retirement begins, thus, the age at which those who are entitled to a pension actually retire. For employers, the statutory retirement age is the starting point for various rights and duties as well as for structuring options in accordance with the new legislation. For employees, the statutory retirement age constitutes the relevant criterion for supplementary income that can result in a reduction in their pensions (partial pensions), or – also as previously – is possible without any restrictions on the pension level.

- For insured individuals who were born before 1.1.1947, the statutory retirement age will continue to be when they reached 65 years.
- Those born in 1964 onwards will only be able to claim the standard old age pension once they reach 67 years of age.
- The statutory retirement age for those born between 1947 and 1963 has been gradually increased since 2012. This means that the statutory retirement age from 2012 – thus, for those born in 1947 onwards – up to 2029 will initially be increased by one month for each birth cohort and, subsequently, by two months for each birth cohort.

5. Protection of legitimate expectations for part-time work as a pre-retirement measure

Insured individuals who were born before 1.1.1955 and who, prior to 1.1.2007, bindingly agreed, with their employers, part-time working arrangements as a pre-retirement measure within the meaning of Sections 2 and 3(1) no.1 of the German Partial Retirement Act still enjoy special protection of legitimate expectations in accordance with Section 235(2) clause 3 of Volume VI of the German Social Security Code. The retirement age for these insured individuals will not be raised. This means that the standard old age pension can still be claimed once they reach the age of 65 years.

6. Structuring variants for employment contracts before the retirement age is reached

Under employment law there is no entitlement to a reduction in working hours on the grounds of claiming a pension before the start of the standard old age pension. A unilateral right to reduce working hours while taking advantage of the optimal level of supplementary income under pension law could be claimed in the form of a demand for part-time work in accordance with the German Part-Time Work and Fixed-Term Employment Act. In this regard, it should be borne in mind however that the resulting supplementary income has to be correctly projected if employees want to avoid a loss of income in the case of the partial pension before they reach the statutory retirement age. Furthermore, it also has to be taken into account that the forecast for each year will be reviewed during an inspection and every exceedance of the supplementary income will result in a retroactive reduction in the employee’s pension. In turn, this will mean that employees will have to be flexible as to how they organise their future volume of work, also in view of possible adjustments.

» **Please note:** However, the German Part-Time Work and Fixed-Term Employment Act does not recognise this flexibility. Nevertheless, the parties to an employment contract are free to adapt the employment relationship, by mutual agreement in each case, to the changed supplementary income.

7. Structuring variants for employment contracts after reaching retirement age

Once the statutory retirement age has been reached, the supplementary income does not lead to a reduction in the pension (the same as up to now). The parties to an employment contract are free with respect to the type and scope of the structuring of the contract.

If the employee is already working at the company – which should usually be the case – then the agreement about continuing to work should not be made only after the statutory retirement age has been reached. Under employment law, this would lead to a new unlimited employment contract. This could be averted through a limited term agreement for objective and material reasons; however, in the event of a dispute this would harbour a financial risk for the employer. As a matter of fact, if the contract is subsequently deemed to be inadmissible then the supposedly fixed term contract would be transformed into an unlimited one.

The prohibition on the serial use of fixed-term agreements, in accordance with Section 14(2) clause 2 of the German Part-Time Work and Fixed-Term Employment Act, means that fixed term contracts for no objective and material reasons will not be recognised. Limiting an employment relationship for no objective or material reason is not permitted if an employment relationship had previously existed with the same employer.

For those for whom the employment relationship will automatically end when they reach the statutory retirement age, the legislature has a structuring tool available for employers that can normally be applied in practice. According to Section 41(3) of Volume VI of the German Social Security Code there is the following option: “If an agreement provides for the termination of the employment relationship once the statutory retirement age has been reached then the parties to an employment contract can agree during the employment relationship to postpone the date of termination of the contract, if required, a number of times.

Strong recommendation – document the internal allocation of duties

8. Further information and support

If you need further information you can contact the information and advice centres of the Deutsche Rentenversicherung (German Federal Pension Scheme). Please visit:
www.deutsche-rentenversicherung.de
http://flexirente.drv.info

As an employer, please do not hesitate to contact the PKF consultants specialised in employment law.

Limiting liability when allocating responsibilities among several managing directors – Documenting the allocation of duties is particularly important

» **Who for:** Companies with several managing directors who have different areas of responsibility.

» **Issue:** If several people in a company are appointed to the executive board, frequently, there is an internal allocation of duties through which certain management areas are assigned to particular people. However, this does not automatically ensure that the respective managing director can only be liable for mistakes in the department for which s/he is responsible. In this respect, the principle of overall responsibility applies, i.e. each managing director is responsible for the fulfilment of all obligations.

The allocation of duties only has the effect of limiting liability if these responsibilities are clearly and unambiguously specified beforehand and in writing. This can be done in the articles of association, through a shareholders’ resolution or through an agreement between the shareholders and managing directors. Frequently, the assignment of duties is carried out within the framework of the rules of procedure adopted at the general meeting, or a plan for the allocation of responsibilities. The latter should then also include rules about how the managing directors should share information with each other and come to agreements. In fact, limiting liability to the department is only valid as long as there is no reason to doubt that the other managing directors are performing their duties properly. Therefore, each managing director remains obliged, to a certain extent, to check that his/her fellow managing directors are performing their duties. However, if the company were to enter a state of crisis then unrestricted overall responsibility would be revived once again. Relying on the allocation of responsibilities is then generally no longer an option.

» **Recommendation:** The internal allocation of duties should, in any case, be unambiguously regulated and specified in writing. The necessary monitoring of fellow managing directors has to be documented.

» **More Information:** The principles described above are consistent with established case law and, once again, were expressly confirmed in a ruling by the Bremen tax court from 26.11.2015 (case reference: 1 K 20/15 5) with respect to a case relating to payroll tax liability.

Information obligations for businesses regarding their participation in dispute resolution processes

» **Who for:** Businesses in all industries.

» **Issue** Sections 36 and 37 of the German Act on Alternative Dispute Resolution in Consumer Matters (*Verbraucherstreitbeilegungsgesetz*, VSBG) came into force on 1.2.2017. Since then, certain businesses have been obliged to provide information, to consumers, about their participation in dispute resolution processes.

Section 36 of the VSBG is aimed at businesses that employed more than ten people in the December of the previous year and that operate a website or use general terms and conditions vis à vis consumers. Such a business has to inform consumers, in an easily accessible, clear and comprehensible way, whether or not it is prepared to participate in dispute resolution processes. If this is the case then the competent dispute resolution body (e.g. the *Allgemeine Verbraucherschlichtungsstelle des Zentrums für Schlichtung e.V.* [General Consumer Conciliation Body of the Centre for Conciliation]) has to be mentioned together with its address and website. The corresponding information has to appear on all websites and GTCs used vis à vis consumers.

In addition, under Section 37 of the VSBG, if an actual dispute arises then businesses are required to point out explicitly to consumers that there is the option and willingness to use conciliation to resolve the dispute.

» **Recommendation:** Businesses should ensure that they comply with Sections 36 and 37 of the VSBG and check their websites and GTCs in this respect to see whether or not these include the requisite information about dispute resolution processes. Furthermore, businesses should check to see if they are obliged to participate in dispute resolution processes or, alternatively, if they are prepared to do so and which dispute resolution body should be considered. Employees who have contact with customers should be advised that if there is a dispute then reference has to be made to the dispute resolution processes pursuant to Section 37 of the VSBG.

» **More Information:** You can find more information (in German) about dispute resolution in consumer matters as well as a list of different dispute resolution bodies at https://www. bundesjustizamt.de/DE/Themen/Buergerdienste/Verbraucherschutz/Verbraucherschutz_node.html

ACCOUNTING

Information on the keeping and retention of accounts and records in electronic form

» **Who for:** Companies that keep and retain records and documents in digital form.

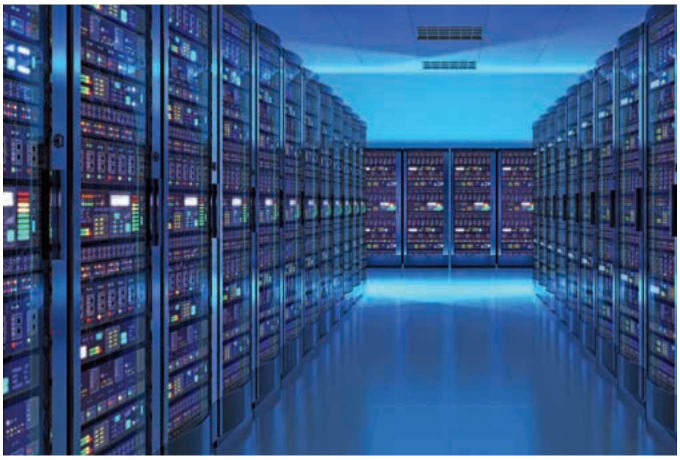
» **Issue:** In 2014, the tax authorities adopted new ‘Principles of Proper Keeping and Retention of Accounts, Records and Documents in Electronic Form as well as Access to Data’ (*Grundsätze zur ordnungsmäßigen Führung und Aufbewahrung von Büchern, Aufzeichnungen und Unterlagen in elektronischer Form sowie zum Datenzugriff*, “GoBD”). In view of a ruling that has been issued in the meantime and the initial experiences with tax audits, we are able to pass on some practical advice as regards GoBD compliance in accounting departments:

(1) Upstream systems and ancillary systems – It is not only the actual accounting program that is subject to the regulations in respect of accessing data for the tax audit, but also the upstream systems and ancillary systems, insofar as they are relevant for taxation. This is broadly interpreted and ultimately applies to all systems that have any connection with accounting (e.g. fixed asset accounting and payroll accounting, cash register systems, ERP systems and billing systems, document management systems and also industry-specific software). Moreover, such systems have to be tamper-proof, i.e. the data has to be stored without any possibility of changes being made and any amendments have to be logged.

» **Recommendation:** In practice, this will frequently not be the case. The latest program versions should be used here and GoBD compliance should be ensured.

(2) Retention of documents/statements of account – Documents should generally be stored in the form in which they were submitted. That is why, for the duration of the mandatory record keeping period, documents that were received electronically have to be stored electronically and without any possibility of changes being made. Moreover, they have to be safeguarded against loss and made available for an external digital audit. This also applies to online statements of account, as the Bavarian State Office for Taxes clarified in a ruling from 20.1.2017.

» **Recommendation:** It is therefore not enough to print out the statement of account and retain the paper copy. It is the view of the State Office that this should apply not only to businesses that prepare accounts but also to ones that use the cash method of accounting. You should take heed of the requirements of the tax authorities in the area of digital accounting in order to minimise the risk of add-back estimates. If you are in any doubt then please do not hesitate to contact your PKF consultant.



GoBD compliance protects against the risk of add-back estimates

CORPORATE FINANCE

Virtual stock programmes for employees – Combine an inflow of capital with staff motivation

The forms of financial participation that have been established in the capital markets usually remain closed to startups and medium-sized enterprises in the legal form of a GmbH (German limited company). Genuine ownership interests in the share capital would require high administrative expenditures and, in addition, certification by a notary, which would also entail costs. That is why so-called virtual shares for employees offer an alternative.

1. Mechanism

BIn the case of virtual shares for employees, an agreement in accordance with the law of obligations is set up between the company and the employee. In the course of this the employee receives the right to a payment amounting to the increase in enterprise value or a portion of the company's annual profit if the shareholders with holding interests approve a profit distribution. In this respect, the employee is put virtually in the same position as a real shareholder but without being granted any voting rights, control rights or other rights.

2. Legal aspects

For employees, a virtual stock model is essentially a special type of bonus model. As regards the legal structure, there are extensive contractual freedoms while taking into consideration the boundaries of employment law. The rights arising from the virtual share model will be agreed between the company that is granting them and the benefitting staff member and will be tied to the benefitting staff member's employment contract.

The agreements should incorporate provisions e.g. on the vesting period of the virtual shares, on tying employees to the company, on the potential expiry of the shares (so-called vesting arrangements), on what happens if the employee resigns and, in particular, provisions defining what happens in the event of a sale (exit).

Besides the substantive issues, the computational aspects can be outlined in order to achieve legal certainty about the calculation of the virtual proceeds in the event of a sale. Virtual share models differ, in particular, with respect to the definition and the method for calculating the increase in enterprise value. These focus on the corporate goals themselves as well as on the budget for the individual agreements. The most common formula for calculating the increase is based on the base price of the virtual share that is determined when the employee financial participation model is completed and defined in the agreement. On the exercise date the employee will receive the difference between the current value and the base price.

3. Tax aspects

The remuneration that employees receive with virtual shares, as bonus payments, usually constitute income from employment and they raise the assessment basis for payroll tax as well as for social security contributions. When this remuneration has to be taxed is determined by the date on which the proceeds are paid to the virtual shareholder. Granting virtual shares does not give rise to a basis for taxation because, in this phase, but a right is established to a date only as specified in an agreement. For the company, profit distributions have the impact of an outflow of liquidity with no effect on earnings. By contrast, outgoing payments based on the virtual participation contracts constitute business expenses in the agreed amount.

4. Incentive structures

The attractiveness of virtual share programmes lies especially in the contractual freedoms and the possibility to adapt these to the circumstances and structures of the respective company (in particular startups). Young companies, particularly those projecting steady growth but currently (still) not able to pay salaries to their employees at the usual market rate, can tie those employees who are necessary for success to the company and ensure that they will share in the company's success. The participation of the benefiting employees in the company's success enhances their identification with the company and also their motivation to drive the company forward through their own performance.

Virtual shares enhance employee motivation

» **Recommendation:** We recommend involving experts at an early stage to help you work out which virtual participation programme would be ideal for your company. Your PKF team would be pleased to help you in the challenge to develop the ideal programme together with the corresponding legal and tax solutions.

IN BRIEF

Update on the Restructuring Decree

On 28.11.2016, the Federal Fiscal Court (Bundesfinanzhof, BFH) ruled that the Restructuring Decree was unlawful. Therefore, "restructuring profits" should no longer enjoy tax concessions, or only under very strict conditions (cf. PKF Newsletter 3/2017). The German government has now responded to the BFH by drafting a new Section 3a of the German Income Tax Act. The provisions in the old Restructuring Decree will be transferred to a large extent into the Act.

The debt waiver for the purpose of a business-related restructuring would be tax-exempt. Business owner-related restructuring would also be tax-privileged. A complex system of priority offsetting is planned for losses. This revision still has to be approved by the EU in respect of the state aid aspects. According to the circular by the Federal Ministry of Finance, from 27.4.2017, for reasons of legitimate expectations, the Restructuring Decree will in any case still apply to debt waivers until 8.2.2017.

Legal and tax consequences of exiting for UK limited companies

A Limited (Ltd.) Company is the British equivalent of a German *GmbH*. When compared with the cost of setting up a GmbH, it is much cheaper to establish a Ltd. Company, with its head office in Germany, and that it why it is also an attractive legal form over here. The freedom of establishment covers setting up a Ltd. Company with its head office in Germany and, according to the incorporation theory, which is applied by the ECJ, the rules under which companies from other EU countries have been formed in their states of origin also apply in Germany. As a consequence, a Ltd. Company, with its head office in Germany, is recognised as being a legal entity and the limited liability of the partners is accepted.

If the United Kingdom (UK) does not join the European Economic Area, or if no special rules are adopted for British companies then, due to Brexit, only third country status will remain. As a result, freedom of establishment will cease to apply and a Ltd. Company will be subject to the seat theory.

Therefore, a Ltd. Company would be at risk of being forced to change its legal form into an *OHG* (a general partnership) or a GbR (company/partnership under German civil law), which would mean that the partners would be liable to creditors to an unlimited extent. This unwanted change of legal form would also have far-reaching tax consequences. On the one hand, there is a risk of taxation on the change of legal form itself. On the other hand, there would be a change of tax regime for the on-going taxation.

In order to prevent the negative effects that would ensue from a change of legal form the following alternatives would be available and, if necessary, they should be implemented before Brexit happens:

(1) Cross border merger of a Ltd Company with a company based in Germany.

(2) Cross border change of legal form into that of a German GmbH (private limited liability company). German provisions on changing the legal form of a corporation into a GmbH would be applicable.

(3) Transfer the business operations of the Ltd Company into a newly founded GmbH by way of an asset deal.

AND FINALLY...

"In general, the art of government consists in taking as much money as possible from one party of the citizens to give to the other."

Voltaire, French philosopher (1694–1778)

Impressum

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