PKF

Accountants &
business advisers

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Editorial

Dear Readers,

If a legislative change is heralded as a reform then, by now, this is an almost unmistakable sign that a matter that is, in any case, difficult or controversial will be regulated in an even more complex manner in the future. The German government has produced proof of this once again with the Investment Tax Reform Act (abbreviated in German to InvStRefG). In our Focus section, we have attempted to explain the inexplicable, which will come into force on 1.1.2018.

Compensation time accounts can be a component of a plan for an early retirement. A ruling from Baden-Wuerttemberg, which we have reviewed in the 'Tax' section, provides clarity with regard to the timing of the taxation. The article that follows deals with the tax treatment of shareholder loans in a crisis. Despite the reform to the regulations on equity replacement, the tax authorities had nevertheless continued to allow these loans to be taken into account, for tax purposes, as subsequent acquisition costs for the shareholding. However, the Federal Fiscal Court has now prohibited this (for the time being).

Managing directors are the focus of our 'Legal' section. The first article deals with the limits of legal transactions with oneself. The second contribution is concerned with the limits that a managing director service contract may set with respect to age limits.

In the 'Accounting' section, in the final part of our series on intangible assets, we discuss the recognition of the costs for a brand relaunch.

Finally, under 'Corporate Finance' you can read a detailed report about the provisions of the Markets in Financial Instruments Directive MiFID II, that are also relevant for those non-banks that conclude derivative contracts. MiFID II has a lot in common with the above-mentioned InvStRefG: it will apply as of 2018, it is complicated and poses a (financial) mathematical challenge for users.

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

Your PKF Team

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FOCUS

Investment Tax Reform Act will turn the previous tax regime upside down

When the new Investment Tax Reform Act (Investmentsteuerreformgesetz, InvStRefG) comes into force, on 1.1.2018, it will profoundly change the current rules for the taxation of investment funds. The German government wants to ensure that investors in funds which do not distribute income (accumulating funds) and those that distribute only some income will also have to pay tax on a minimum amount in the form of an advance lump sum. The same partial tax exemptions will apply to these, as is the case in the taxation of distributions. The amount of the tax-exempt portion here will also be based on the type of fund.

1. Affected funds

The aim of the reform, besides satisfying the requirement under European law for equal treatment of domestic and foreign investment funds, is above all to simplify the taxation of mutual funds at the investor level. This does not include investment funds that operate as partnerships (e.g. *Investment KG* - a German investment limited partnership - and closed-end funds), and pension funds. For so-called Riester and Rürup contracts (for German subsidised pension products) the current form of taxation will remain unchanged. Morever, unit-linked life or pension insurance policies will also continue to offer the benefit under which investors do not have to pay tax on dividends and interest during the accumulation phase.

2. Taxation at fund level

Under the hitherto applicable transparency principle, up to 33 types of income were calculated for funds and reported separately to the investor. However, the investment income was tax-exempt at fund level and it was only the investors who had to pay tax on the income. Investors were effectively placed in the same position as if they held a direct stake in the fund's underlying assets in the amount of their investment. From 2018 the principle of separability (*Trennungsprinzip*) will apply - besides the investors, the investment fund itself will be a taxable entity. Tax at a rate of at least 15% will be levied on income at fund level.

3. Taxation at investor level

Investors will have to pay tax once more on the investment income within the scope of withholding tax (25% plus solidarity surcharge and, if applicable, church tax) if they exceed their saver's allowance of € 801 per taxpayer. Investment income includes distributions, capital gains and advance lump sums (accumulated investment income).

The newly introduced advance lump sum is defined as the income base amount minus the distributions of the last financial year, however, the maximum amount would be the positive increase in the value of the fund unit.

The base income amount B, in this case, would be determined as follows:
B = 0.7 x base interest rate x redemption price of the fund unit at

the start of the calendar year

» **Example:** Calculation of the advanced lump sum for 2018 (advance 2018) with the tax accrual on 2.1.2019. The assumption is that the first redemption price determined in 2018 will be € 100:

Case 1a: Price as at 31.12.2018 = € 120.00
No distribution in 2018
Advance 2018 = 0.7 x 1.10 % x € 100 = € 0.77

Case 1b: Price as at 31.12.2018 = € 120.00
Distribution in 2018 = € 0.5
Advance 2018 = € 0.77 minus € 0.5 = € 0.27

Case 2: Price as at 31.12.2018 = € 100.50
Advance 2018 = 0.7 x 1.10 % x Euro 100 = € 0.77, but limited to € 0.50 (value increase in the calendar year)

4. Partial tax exemptions for private investors

In future, there will be double taxation – first at fund level and then at investor level. In order to lessen the double taxation, the law provides for certain partial tax exemptions for investors the amount of which will depend on the capital structure of the funds concerned. For inves-

tors to be granted the respective partial exemptions, the equity held by equity funds has to be at least 51%, or at least 25% in the case of balanced funds, and property funds have to hold at least 51% in property. The funds may not fall below these thresholds throughout the year. The investor has to provide evidence that these thresholds have been observed. In the event of legally compliant adherence there are the following partial tax exemptions:

	Aktienfonds	Mischfonds	Immobilien-fonds
Private Anleger mit Anteilen im Privatvermögen	30%	15%	60%*
Private Anleger mit Anteilen im Betriebsvermögen	60%	30%	60%*
Institutionelle Anleger	80%	40%	60%*

* Fonds, die zu mehr als 51% in ausländische Immobilien investiert haben: 80%.

5. Abolition of the grandfathering rule

For funds acquired prior to 1.1.2009, the grandfathering rule for the so-called old fund units in personal assets will be abolished. Up to now, any capital gains generated from such fund units were tax exempt. This provision has been eliminated. While increases in value up to 31.12.2017 will remain tax exempt, as of 2018, any changes in the future will be taxable. The tax exemption will be replaced by a tax-exempt amount of € 100,000 per investor. In order to avoid taxation in the future, units where the capital gain would exceed the tax-exempt amount should be transferred to as many people as possible. This could be realised through gifting, however, this would have to be carried out before the new act comes into force.

Given the significant changes, all fund units will be deemed to be sold on 31.12.2017 and re-acquired on 1.1.2018 at book values that will then be currently applicable. However, the gains or losses will only be taken into consideration when the units are actually sold; thus, investors who prepare accounts will initially not have to report the amount in their tax accounts. This transitional provision will apply to units in business assets until 31.12.2021. For units in personal assets the deemed gains will have to be determined by 31.12.2020.

6. Recommendations

Anyone who acquired funds prior to 2009 should basically hold on to them; when the funds are sold the tax-exempt amount of € 100,000 can be used. The tax-exempt amount can also be multiplied through gifting. You should continue to review the capital structure of investment companies in which you have invested. In any case, the new law is already very open to interpretation before it has even come into force. The first Federal Ministry of Finance (BMF) circular on questions was published already on 14.6.2017 (case reference: V C 1 - S 1980-1/16/10010) and others will follow. In cases of uncertainty or significant investments it would be advisable to talk to your financial adviser and/or your PKF consultant.

TAX

Make use of the tax deferral that compensation time accounts provide

» **Who for:** Corporations with tax loss carry-forwards.

» **Issue:** Employees may enter into an agreement with their employers with respect to the maintenance of compensation time accounts (accrued benefits agreements). In this case, part of the employees' pay is credited to compensation time accounts. Employees can use this credit for an early retirement scheme or to reduce the contractually agreed working time. In its ruling of 22.6.2017, the Baden-Wuerttemberg tax court decided that the pay that is credited to the account does not have to be taxed until the payout phase. There is thus a tax deferral and, potentially, a reduction in the tax burden if, on the payout date, the tax rate is lower than during the vesting period.

The accrual principle also applies if, in the event of a change of employer, the new employer takes over the compensation time account and continues to maintain it until a leave of absence. Furthermore, as a backup, employers can take out re-insurance cover for the compensation time accounts and pay a part of the employee's salary directly into the working time account at the insurance company. It does not matter when the payment is made to the insurance company, – which was the basis of the assessment by the local tax office in the case in question – as it is only when it accrues to the employee that it has to be taxed. Ultimately, the tax court decided that, in the case of compensation time accounts that pay interest, the interest is also part of an employee's pay and

is only subject to tax when it is paid out as income from employment.

» **Recommendation:** The ruling from 22.6.2017 (case reference: 12 K 1044/15) can be found under www.fg-baden-wuerttem-berg.de. The local tax office has lodged an appeal with Federal Fiscal Court (Bundesfinanzhof, BFH) (BFH case reference: VI R 17/16, s.u. www.bundesfinanzhof.de).

Can losses arising from loans to corporations no longer be utilised for tax purposes?

» **Who for:** Shareholders of corporations who grant the latter a loan or a guarantee.

» **Issue:** In its ruling from 11.7.2017 (case reference: IX R 36/15), the Federal Fiscal Court (Bundesfinanzhof, BFH) decided that, in the case of holdings of personal assets (≥1%), a default on a loan that a shareholder has given to a corporation does not generally constitute subsequent acquisition costs for the company's shares. The same is true for expenses that arise from a claim as a guarantor.

In the past, the key condition for favourable tax treatment was that the reason for granting the loan (or guarantee) was the corporate relationship. This was usually deemed to exist if the loan had been granted, or an existing loan was not withdrawn at a point in time where, due to the financial situation of the company, the repayment of the loan would have been at risk to such an extent that a prudent business person would not have been prepared to incur the risk of granting credit at the same conditions as those of the shareholder (a so-called crisis loan). In the event of a default on the loan, or if the guarantee is called in, then this would lead to subsequent acquisition costs for the shareholder for his shares.

The consequence was that profit from a subsequent sale of the shareholding was reduced accordingly, or there was a corresponding increase in disposal losses. In this respect, for tax purposes, the loan was treated as equity (equity-replacing financial support).

The basis for the above treatment was the regulations on equity replacement under company law. Since the abolition of the same in 2008, under insolvency law, shareholder loans are generally subordinated. Nevertheless, initially, the tax authorities continued to apply the previous principles and loans or guarantees were regarded as equity replacement by reason of the corporate relationship (cf. Ministry of Finance (BMF) circular from 21.10.2010; German Federal Tax Gazette (Bundessteuerblatt, BStBl) 2010 I p. 832).

Up to the date on which the ruling was published, 27.9.2017, the BFH will grant protection of legitimate expectation in the hitherto legal situation if the shareholder has provided equity-replacing financial support, or if, up to that date, the financial support provided by the shareholder has become equity-replacing.

» **Recommendation:** In future, when committing funds to a company you should look more carefully into configurations, such as, the sale of (worthless) receivables in order to be able to utilise the loss within the framework of investment income.

» **More Information:** A few days ago, the tax authorities also voiced their opinions and, for example, with the decision of the Lower Saxony regional tax office, from 9.10.2017 (case reference: S 2244-118-St 24), announced that coordination meetings have to take place at the level of the highest tax authorities of the federation and those of the Länder (Federal States) and that it is necessary to wait for the outcomes of these.

ACCOUNTING

The recognition and measurement of internally generated non-current intangible assets – Part 4 – A brand relaunch

A brand relaunch can involve making adjustments to a portfolio of products and/or services targeted at a specific group, or changes to the corresponding marketing communications and the corporate image. As the benefits that ensue affect several subsequent years, the question that arises is whether or not the expenditure required for this - which in most cases is considerable – should likewise be spread over the course of this period. Using accounting terminology, the question is: when should these expenses be capitalised?

1. What is a brand relaunch?

A brand is understood to be a special, legally protected sign that, above all, serves to distinguish the goods and services of a company from competing goods and ser-

vices of other companies. Over time, it may become necessary to differentiate a brand through comprehensive and systematic measures in order to extend its useful life or enable a new use (brand relaunch).

2. Creation of a new brand or the revival of an existing brand?

First of all, for each individual case, it is necessary to check whether (1) through the relaunch, economically speaking, a new brand was created or (2) an existing brand was only revived.

(1) New creation – If, economically speaking, a new brand was created then another distinction has to be made, namely, if external service providers bore the production risk (e.g. if contracts for work and services were concluded) then an acquisition will be deemed to have taken place and this will result in a capitalisation requirement. Otherwise there is a prohibition on recognition for the new brand.

Logo over the course of time

(2) Revival – If an existing brand has been revived then no new asset has been formed so that any further evaluations have to be on the basis of the existing asset:

If, up to now, this asset has not been recognised then the new expenses will share this fate.

However, if the brand was previously recognised then recognition is likewise excluded. Given that there was no direct connection with the original purchase, the costs cannot be deemed to be subsequent purchase costs.

It is only in the special case where the brand is purchased and, in the near term, an external party assumes the producer's risk for the relaunch that subsequent purchase costs incurred have to be capitalised.

3. Extension and/or strengthening

An extension or a major strengthening of an existing brand would likewise not result in the costs incurred being capitalised, as such definitional elements gain significance solely within the scope of production. Internally generated brands, however, are subject to an explicit legal prohibition on recognition.

4. Conclusion

The conclusion is that the expenses for a brand relaunch may thus only be capitalised if, economically speaking, a new brand is created or an acquired brand is relaunched in the near term and an external service provider incurs the producer's risk.

LEGAL

The liability of a Managing Director of a German limited company (GmbH) – The limits of commercial discretion when acting as principal and agent

» **Who for:** Managing directors and shareholders in a GmbH

» **Issue:** In the case in question, a GmbH – which subsequently became insolvent - acquired the assets of a GbR (a company/partnership under German civil law). The defendant ("D") was involved in the transaction in his capacity as a managing co-shareholder in the GmbH as well as a co-shareholder in the GbR. A part of the purchase price - € 25k - was attributable to the goodwill of the GbR, which had not generated any sales revenue and had also not reported any intangible assets in the preceding financial years. Furthermore, the GmbH wrote off the acquired goodwill under German commercial law.

The regional court had still denied that the managing director was liable for the acquisition because the D had subsequently acquired all the shares in the GmbH and was thus acting as the sole shareholder and sole managing director and, consequently, the company could waive any claims against the D in a way that excluded liability. By contrast, in the appeal on 2.6.2017 (case reference: 25 U 107/13), the higher regional court decided that in such a "legal transaction with oneself" the managing director is subject to an additional obligation that made it necessary for the legal transaction, in this case, to be fair and appropriate from the perspective of the company. Here, the managing director himself bore the burden of proof. When determining goodwill, the considerations and calculations that form the basis of this exercise have to be plausibly demonstrated, especially if the purchase of the goodwill is not at a price that is in realistic proportion to the operating income of the transferring company.

The higher regional court concluded that the shareholder's obvious substantial personal interest in being able to wind up the transferring company without incurring losses at the same time as buying it did not fall within the scope of the discretion for business decisions to which he was entitled. Moreover, a waiver by the company for any claims to damages against the managing director would generally be subject to the regulations on avoidance in insolvency.

» Recommendation: The above-mentioned ruling spells out a managing director's risks when carrying out a legal transaction where he acts as both principal and agent. We would be pleased to help you to obviate such risks

Being 60 years of age as valid grounds for giving notice to a managing director of a German limited company (GmbH)

» Who for: Shareholders in a GmbH who plan to agree an age-related exceptional right of termination when appointing an external managing director.

» Issue: Many GmbH managing director service contracts include contractual clauses that provide for the termination of the contract when a certain age is reached that is below the statutory retirement age. Now it should be possible to lawfully agree, in a service contract, that reaching 60 years of age would also be grounds for an ordinary termination.

This is what was decided by the higher regional court (Oberlandesgericht, OLG) in Hamm in a recent case (ruling from 19.6.2017, case reference: 8 U 18/17). The claimant ("C") had been chairman of the managing board of a GmbH since 2005. The service contract that had been agreed between the parties provided for, firstly, automatic termination by limiting the period of the employment relationship to 31.12.2018.

Furthermore, the parties had mutually agreed that they would have the option to give ordinary notice of termination once the C had reached 61 years of age. In 2015, C was relieved of his office as managing director and, in June 2016, the GmbH gave the 61-year old C notice of his termination as of 31.12.2016. However, the proceedings instituted by the C against this as well his appeal to the OLG Hamm were unsuccessful.

The OLG judges did indeed view the contractually agreed option to give notice of termination before reaching the statutory retirement age as discrimination against the C because it was linked to his age. Nevertheless, the contractual provision was legitimate as, after the termination of his employment relationship, he was entitled to a company pension, which ensured adequate social security. In the opinion of the judges, the company had a legitimate interest in handing over the management of the business to a successor early on; there is thus a need for an agreement on age limits that are below the statutory retirement age. The appeal made to the Federal Court of Justice under case reference II ZR 244/17 is still pending.

CORPORATE FINANCE

MiFID II – Financial market regulation applicable from 2018 will also be relevant for corporate treasurers

As part of the introduction of the German Second Act Amending Financial Market Regulations, MiFID II (Markets in Financial Instruments Directive II) will come into force as of 3.1.2018. This is targeted especially at financial services providers and focuses in particular on investor protection, market transparency as well as the regulation of derivative transactions and organised trading facilities. In addition, MiFID II will however also have far reaching effects on non-banks, especially firms with trading activities in product and commodity derivatives.

1. General licence obligation ...

In future, all trading transactions in commodity derivatives as well as emissions certificates that are used for own account business and thus to hedge risks will be subject to a licence obligation. In these cases, this will be explicitly for all transactions in derivatives, regardless of whether or not they are exchange-traded or OTC transactions.

... with exemption rules

A successful licensing procedure would entail considerable effort and expense as well as additional rules such as, in particular, those relating to capital requirements. For companies that use such hedging transactions in the course of their normal business activities or for their own account trading only to a small extent, the legislator has provided for exemption rules for ancillary activities. To this end, companies have to submit the appropriate notification to German Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin*).

Please note: For the first-time application of the exemption rules, the notification will already have to have been submitted by 3.1.2018 and, for subsequent years, always in the first quarter of the calendar year. There are no formal guidelines from the supervisory authorities available yet as to how this notification should be drawn up, but it is expected that they will become available.

2. Exemption test rules

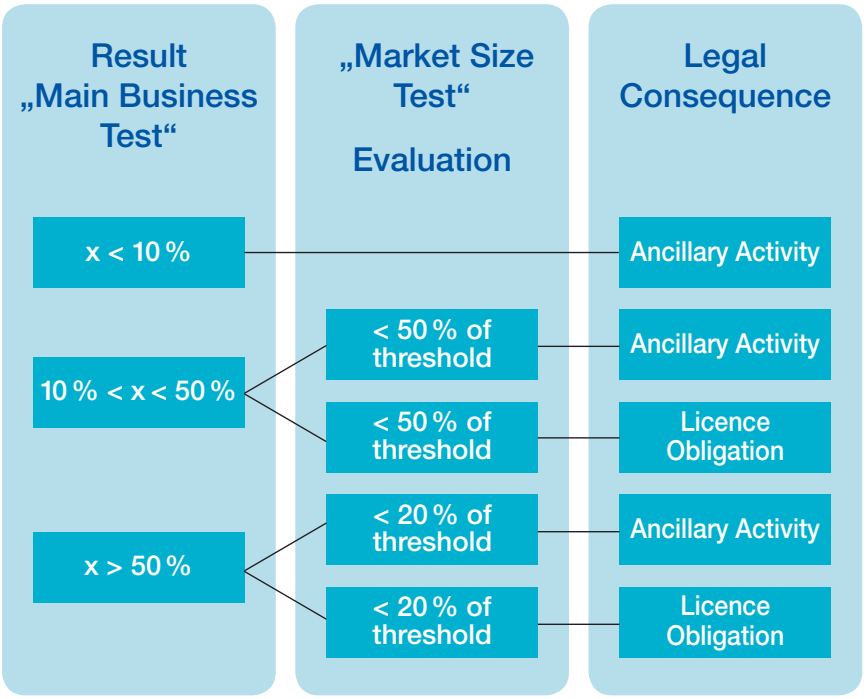
It is likely that proof or documentation with respect to the exemption rules would only have to be provided subsequently if BaFin were to request this. For this purpose, to begin with, transactions in derivatives for risk hedging, as privileged trading activities, should be separated out from non-privileged transactions that are speculative in nature.

On this basis, essentially a two-step test has to be performed to determine whether or not the ancillary activity exemption applies:

(1) Market Size Test - The non-privileged trading activities have to be measured against total market sizes. In this case, the total market sizes have to be specified by a public body. In order to benefit from the exemption rules these trading activities have to fall below a threshold. The threshold will differ depending on the type of the underlying commodity or product (e.g. metal, oil, coal, gas, agricultural products, etc.).

(2) Main Business Test - There is a choice here between two methods that relate to the main activity of a company or a group of entities.

- Trading-related test - This measures a company's non-privileged trading activities against the group's overall trading activities (incl. privileged transactions).
- Capital-based test - In this connection, 15% of each net position and 3% of the gross positions (in each case multiplied by the price of the commodity derivative, of the emissions certificate or a derivative thereof) held by a company are measured against the capital employed by the group for its main activity. In this case, the latter consists of the sum of the group's total assets minus its short-term debt as recorded in the consolidated financial statements of the group.



Ancillary activity exemption test

In the case of a market size test and a trading-related main business test the consequences would be as depicted below.

Note and recommendation: All calculations should always be performed and documented for the last three financial years. It is not possible to obtain any clear guidelines from the legislative proposal for the scope of the calculations or for the documentation and argumentation. Companies without any speculative transactions in product

and commodity derivatives and, thus, test results of zero, should be able to dispense with complicated calculations if they are able to produce the appropriate proof.

3. Changes for procurement platforms

Procurement platforms also affect non-banks that procure gas, electricity or certificates for their clients and, thus, do not trade on their own accounts.

Operators of such platforms are not able to avail themselves of the exemption rules and have to apply to BaFin for a licence in order to be able to continue carrying out their transactions.

Please note: You should bear in mind that that these rules will also apply to companies that give specific recommendations to their customers and not just price information.

4. A need for action

Low levels of trading in derivatives will already mean that there is a need to take action even if these transactions were concluded for risk hedging purposes.

You should pay attention here to the fact that if there is a request from the supervisory authorities for documentation and calculations these will have to be credible

IN BRIEF

Is an interest rate of 6% constitutional when determining pension provisions for tax purposes?

For some time now there have been serious doubts as to whether or not taking into account an interest rate of 6% when determining pension provisions for tax purpose is constitutional. The Cologne tax court, in its decision from 12.10.2017, now takes the view that the government may indeed determine standard interest rates, but it then has to review these at regular intervals. Against the background of the prolonged low interest rate phase, this interest rate is no longer realistic. The Federal Constitutional Court will now decide whether or not the standard interest rate should be reduced. We will keep you up to date on any further developments.

AND FINALLY…

"In any moment of decision, the best thing you can do is the right thing, the next best thing is the wrong thing, and the worst thing you can do is nothing."

Franklin D. Roosevelt, US President 1933-1945, 30.1.1882 – 14.4.1945

Impressum

PKF Deutschland GmbH Wirtschaftsprüfungsgesellschaft

Jungfernstieg 7 | 20354 Hamburg | Tel. +49 40 35552-0 | Fax +49 (0) 40 355 52-222 | www.pkf.de

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