PKF

Accountants &
business advisers

PKF newsletter 09|18

Editorial

Dear Readers,

In the Focus section of this issue of our newsletter we enlarge upon the PKF Tax CMS Model by discussing the '**payroll tax/ social security**' module. This one – like the one on the (German) Principles of Proper Keeping and Retention of Accounts, Records and Documents in Electronic Form as well as Access to Data (GoBD), presented in the last issue – should be allocated to **risk analysis (Phase II)**. First of all, using practical examples, we have set selected risks in 'real life scenarios' by providing assessments of their extent of loss and occurrence probabilities. In the course of this, the processes that have been put in place at the company and the existing measures for guidance and monitoring, as well as the controls that have already been implemented for the transition from gross risks to net risks, are taken into account.

The contents of the Tax section, which follows, are very extensive due to current developments and the many fundamental court rulings. In the first contribution, we report on an important change in the way costs are apportioned at international companies. The German tax authorities have aligned their requirements with the new OECD Transfer Pricing Guidelines and this will mean that a profit mark-up on costs that are apportioned is likely to become the norm. Next up, there is a discussion of a recent ruling that, to a certain extent, has opened up the possibility of arrangements that would result in rental income being exempted from trade tax. This is followed by a report on the amended guidelines on the taxation of employees who are posted abroad or who go on a business trip – in the future, a company's taxation process will have to be adapted to these. In the final article in this section, you can then read about everything that can be deemed to be remuneration and how or where this has to be subjected to social security tax.

In the 'Latest Reports' section, first of all, we present the special cases for calculating excess withdrawals and the conditions for transferring tax loss carry-forwards. This is followed by information about the effects arising from the new mortality tables. The final article on the issue of whether or not the gift of a luxury cruise for your beloved should be subject to gift tax is more likely to raise a smile rather than be of any practical relevance.

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

Your PKF Team

Contents

FOCUS

Tax Compliance Management Systems – Part D: Risk analysis using the example of payroll tax/social security (Phase II of the PKF Model)

Following the presentation, in our last newsletter, of Phase II of the PKF Model using the example of the (German) Principles of Proper Keeping and Retention of Accounts, Records and Documents in Electronic Form as well as Access to Data (GoBD), our series now continues with examples from the payroll tax/social security area (please see the May issue of our newsletter for a complete overview). For this area, too, we describe the requirements for the necessary documentation relating to procedures and processes in order to ensure tax compliance.

1. Risk analysis in the payroll tax/social security area

The article in the last newsletter, on risk analysis using the example of the GoBD, already included a detailed presentation of the process steps that should generally be carried out within the scope of Phase II:

- Documentation of processes
- Identification of existing measures and controls
- Determination of process risks
- Assessment of the risks relating to the extent of loss and occurrence probability

To this end, during the practical implementation, the risks in these processes are identified in the course of interviews. On the basis of planned questions, the rules and controls that already exist in the company are reviewed and the risks are assessed as well. The ensuing result is a report on the risk situation and the definition of action strategies for reducing the risks.

In the following section, the work involved in applying the PKF Model is illustrated by using the example of benefits in kind at a company. Benefits in kind are, e.g., company events, free meals and drinks for business partners and employees, gifts for business partners and employees, discounts for employees, travel expenses, the use of a vehicle, work clothes, medical care by a company doctor, employer loans, a company apartment, tickets for local public passenger transport and much more besides. In the course of the operating procedures it has to be ensured that the personnel department, or the staff member responsible for employee data receives all the information on the respective benefits in kind. Normally, this is only possible if, at the company, checklists and forms have been introduced that facilitate the collection of the necessary data.

2. Example of application – Company Events

2.1 Circumstances and principles

In most companies, there are parties at Christmas and in summer for the individual businesses but also for individual departments. Such parties are typical examples of company events. The definition of a company event is an event of a social nature that fosters contact between employees and is thus supposed to ensure that there is a good working atmosphere. A distinction has to be made between company events and, e.g., customer events or incentive events.

The group of those participating in a company event should consist of mainly, i.e. more than 50%, company employees, their accompanying guests and possibly temporary staff hired through an agency or employees who work for the corporation. The event has to be open to all employees, including the part-time employees and temporary employees. A company event will be tax-exempt if the costs per employee do not exceed the amount of € 110 and the employee has participated in a maximum of two company events per year. Participation in company events thus has to be individually recorded for each employee. If the expenses per employee for a company event exceed the above-mentioned tax-free allowance then the benefit will be taxed at a flat rate of 25% plus the solidarity charge and church tax. Gifts in kind in the context of company events increase the costs of the event. In the case of raffles there are particularities that have to be complied with. Travel costs incurred in connection with company events are not included in the (tax deductible) costs for the company event. Having due regard to the company's overall activities, the VAT will be deductible if the € 110 limit has not been breached.

One possible process risk could be that the requisite documentation obligations with respect to those participating in the company event have not been complied with. Owing to the complexity of the technical assessment and the relatively high additional amounts that you can expect to pay in case of detection within the scope of audits, this risk

Fig. 1 The Four Phases of the PKF Tax Compliance Management System

should generally be classified as major in relation to its occurrence probability and the extent of the potential loss.

2.2 Application of the PKF Model

In Phase II there is a check to see what rules are in place (e.g. organisational instructions, training courses, programmes, forms and checklists) that could prevent the occurrence of damage/losses. Furthermore, an analysis is carried out to determine whether or not compliance with these rules is monitored in the company. The amount of costs is called up and, on this basis the risk arising from these events is ascertained. If there is a well-structured operational instruction, which is demonstrably being used, then the actual risk of error is relatively small. The risk remains relatively high for businesses with several company events that have not implemented any instructions for execution and who are unable to provide evidence either of the completeness of the costs or the possible participation by all employees.

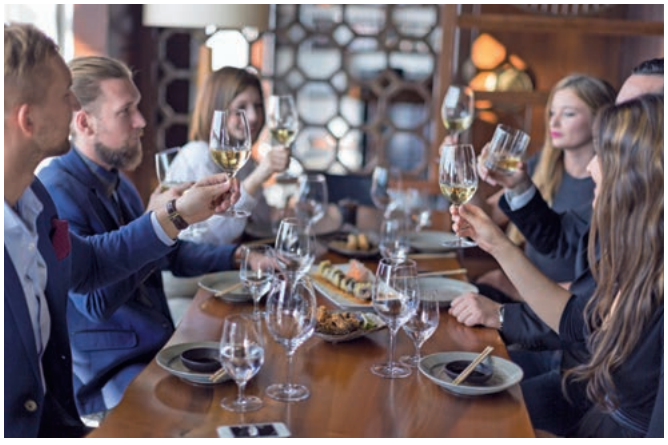
» **Recommendation:** In the case of high risks there is a need for action to mitigate the risks. The report on Phase II would have to describe the risk situation and outline the need for action tailored to the circumstances of the company concerned.

3. Example of application – Travel Costs

3.1 Circumstances and principles

Travel costs (transport costs, subsistence allowances, accommodation costs, and the like) arise in virtually every company. For the reimbursement of travel costs there should be documentation that shows which amounts have to be reimbursed for which trips. In addition, the employee's workplace location should be defined; the records and evidence that are operationally stipulated should conform to the requirements of the tax authorities. If the agreed reimbursements do not conform to tax-exempt per diem allowances then the taxation and, if applicable, payment of social security contributions have to be ensured.

If trips abroad are a regular occurrence at the company then the social security risk is frequently higher than the payroll tax risk. Foreign assignments have to be promptly reported to social security agencies and the statutory trade association for health and safety at work and employer liability insurance (*Berufsgenossenschaft*). In particular, in the event of an accident in connection with a business trip abroad there could be problems with the Berufsgenossenschaft if there is a lack of cover. The employer has to pay the accident costs in advance. If the Berufsgenossenschaft does not assume liability for the expenses this could mean that the company suffers a big loss.



Company events are frequently associated with tax risks

3.2 Application of the PKF Model

In Phase II of the Tax CMS there is a review of how the travel expense accounting is organised and how it is linked to the payroll. Furthermore, how much is paid out for business trips is ascertained. The risk that is determined is reported and a recommendation for action is given.

In addition, with respect to foreign trips, Phase II also provides an opportunity to have a look to see if the guidelines for the authorisation of foreign business trips, which have been put in place, not only guarantee that the travel costs are tax deductible but that they also ensure that the employee will have insurance cover abroad. Here, the risk will also depend on the travel destination but also the number and the duration of the business trips. After recording this information, the risks are identified and assessed. These results are then presented in the report and recommendations for actions are specified.

4. Outlook

These examples give an overview of the approach used in Phase II. On the basis of the ensuing report and the recommendations for actions, the tasks related to the measures for guidance and monitoring that constitute Phase III (cf. Fig. 1) can be designed. This phase will be described in more detail in the next newsletter.

StBin Helga Sauerwald

TAX

New Federal Ministry of Finance circular on cost contribution agreements – The German tax authority has decided to follow OECD guidelines in this respect

» **Who for:** German companies that have been exchanging services with associated foreign companies over a longer period of time.

» **Issue:** If companies produce or obtain services together with associated foreign companies (collectively: pool members) in the common interest of all and over a longer period of time then these services do not necessarily have to be charged for in accordance with the general rules on transfer pricing (incl. a profit mark-up). In fact, up to now, the German tax authorities have been of the opinion that, under certain circumstances, it is possible to distribute the costs incurred for these services among the pool members on the basis of so-called cost contribution agreements (hereinafter: CCAs), according to an allocation formula, and charge them without a profit mark-up. Such CCAs are used, in particular, in connection with

- the joint development, production or the obtaining of intangibles or tangible assets ('CCA for development purposes') as well as for
- services ('CCA for service purposes').

However, the German tax authorities have now aligned their previous opinion with Chapter VIII of the current OECD Transfer Pricing Guidelines, with effect from 1.1.2019, or in the case of existing CCAs from 1.1.2020. The main changes compared with the previous opinion concern the following aspects:

(1) As currently, a company can only participate in a CCA if it is expected that it will benefit from the activities that are being conducted on the basis of the CCA. However, what is new is that, in the future, each participant will also have to have control over the respective risks associated with the CCA. Otherwise, the usually stricter requirements for appropriate transfer pricing shall apply.

(2) Moreover, due to the reference to the OECD guidelines there has also been a change in the way that the contribution to the CCA is measured. To-date, the costs have usually been distributed among the participants without a profit mark-up and according to an allocation formula for the respective expected benefit. In future, the value of a contribution will generally have to be calculated on the basis of the market price. This amendment will be particularly relevant in the case of CCAs for development purposes. By contrast, in the case of CCAs for service purposes it is likely that an allocation on a cost basis will frequently continue to be accepted, at least for activities that add little value.

» **Recommendation:** CCAs with German participation should be reviewed in good time and, if necessary, adapted to the new requirements. In order to be able to determine the permissible group of participants appropriately in future, it will be necessary to carry out an analysis in each case not only of the performance of the functions but also the risk control. Furthermore, particularly in the case of development-oriented CCAs, there should be an examination of the extent to which the contributions of participants are already measured at market-based prices, or the extent to which the exceptions to this principle that have been granted by the OECD in specific cases can be used. Finally, on this occasion, it is likewise advisable to review the compliance with documentation requirements for CCAs.

» **More Information:** The relevant BMF circular up to now on cost contribution agreements from 30.12.1999 along with the new BMF circular from 5.7.2018 can be found at www.bundesfinanzministerium.de (German version only). The OECD Transfer Pricing Guidelines can be found at http://dx.doi.org/10.1787/ 9789264274297-de.

WP/StB Dr. Dietrich Jacobs / StBin Isabee Falkenburg

In the case of joint development, changes will have to be taken into account

Extended trade tax exemption for property despite the limited partners of a GmbH & Co. KG (a German limited partnership with a limited liability company as a general partner) holding an equity interest in a GmbH (German limited company)

» **For who:** Companies that manage properties that would like to make use of the extended trade tax exemption despite an association, under company law, with the tenant.

» **Issue:** The A GmbH & Co. KG (the claimant) had rented out a business property to the Z GmbH & Co. KG with which it was associated, under company law, via an affiliated corporation (Y GmbH). Both KGs were associated via two partners although the Y GmbH was interposed between the Z GmbH & Co. KG and the partners. Then, for the purposes of a tax audit, the A GmbH & Co. KG applied to be allowed to carve out its rental income from the trading tax assessment base. The local tax office refused to recognise this extended exemption for tax purposes (Section 9 no. 1 sentence 2 of the Trade Tax Act (Gewerbesteuergesetz, GewStG)) as it had deemed that the company's activity was not to limited to merely managing its own property because the equity interests in the Y GmbH were held in the special business assets of the claimant's limited partners.

Under certain circumstances, rental income is not subject to trade tax

The Hessian tax court took a different view in its ruling from 24.1.2018 (case reference: 8 K 2233/15). According to this, the extended exemption should only be refused if the management and use of own capital assets – considered individually and independently of any existing commercial character – by its very nature constitutes a commercial activity.

Instead, the income from capital assets generated by the limited partners from holding the equity interest in the GmbH constitutes non-detrimental (from a tax point of view) management and use of capital assets within the meaning of Section 9 no. 1 sentence 2 GewStG. In the opinion of the tax court, the reclassification of this income at the level of the taxpayer on the basis of Section 15(3) no. 2 of the German Income Tax Act does not necessarily lead to the extended exemption being refused as the management and use by its very nature should be regarded as a commercial activity. Furthermore, in the case in question, it was debatable as to whether or not the conditions for a co-partner operational split had been satisfied. The tax court rejected this as the Y GmbH, which did not have an equity interest in the A GmbH & Co. KG, has a screening effect attributed to it, in accordance with Section 9 no.1 sentence 5 no.1 GewStG, that results in the prohibition on the piercing of the corporate veil.

» **Recommendation:** In the opinion of the tax court, the renting out of property by a business partnership to another business partnership with mostly identical partners does not preclude an extended trade tax exemption if a corporation is interposed for the purpose of holding the equity interest in the business partnership that is renting. Such a situation should avoid the creation of a co-partner operational split, which would preclude an extended exemption. In comparable cases, if the local tax office refuses the extended trade tax exemption for property you should lodge an objection with reference to the ruling.

» **More Information:** The tax court has permitted an appeal, which in the meanwhile has been filed with the Federal Fiscal Court (Bundesfinanzhof, BFH) (case reference at the BFH: IV R 7/18). The BFH will thus be able to consider, conclusively, the interpretation of Section 9 no.1 sentence 2 GewStG with regard to the holding of equity interests in GmbHs and the scope of the prohibition on the piercing of the corporate veil with respect to the conditions for an operational split.

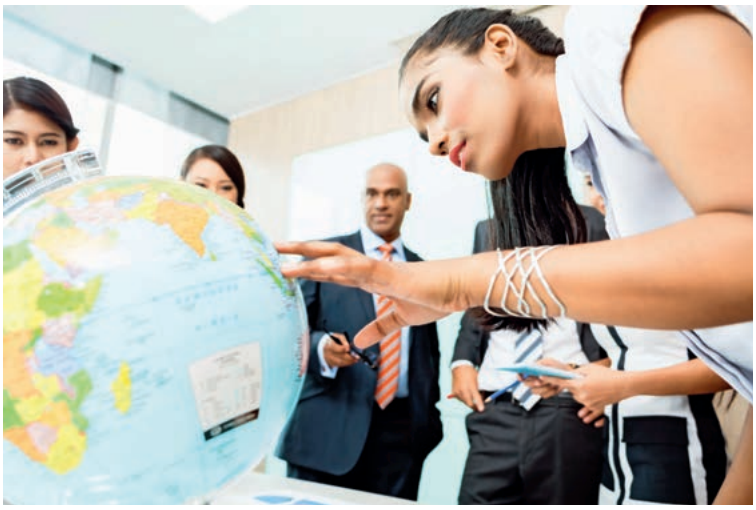
FAStR Dr Carsten Dunkmann

Foreign postings and business trips – Switch your processes to electronic A1 certificates

» **Who for:** Employers that organise foreign postings and posted employees.

» **Issue:** When employees based in Germany are posted abroad then German social security contributions will generally still have to be paid. When employees are posted to a foreign country in the EU, exemption from additional foreign social security is ensured through an A1 certificate. Under Article 12(1) of Regulation (EC) No. 883/2004, employers have to apply for such an A1 certificate to be issued when employees are being posted to other EU/EEA states or to Switzerland (for short: EU

and associated foreign countries) in respect of the health insurance of employees covered by the German statutory scheme. From 2019, you will only be able to file your application for this certificate electronically. The switch will require appropriate changes to be made to your payroll accounting processes:



Important: Submit full notifications of foreign postings electronically and in good time

(1) Data transmission and issuing the certificate – The purpose of the certificate is to exempt the employee from social security contributions in EU and associated foreign countries. It is envisaged that the transmission of the data for the A1 certificate to the employer will happen within three working days after the health insurance provider has conducted a check. The employer has to print out the certificate without delay and issue it to its employee.

(2) Filing an application electronically – Since the turn of the year 2017/2018, employers have been able to file an application electronically for the A1 certificate via payroll accounting software. In 2018 it will still be possible to submit an application in paper form. A1 certificates were still being sent by post up until 30.6.2018, however, since 1.7.2018 there has been a digital response. From 1.1.2019 the electronic procedure shall be mandatory for filing an application as well as for the response.

(3) Carrying the certificate with you – Controls in EU and associated foreign countries have multiplied. The A1 certificate should generally be retained by the employer that has arranged the foreign posting. Employees should carry a copy around with them in order to be able to prove their exemption from social security contributions.

(4) Caution with respect to business trips – A posting constitutes temporary employment in a foreign country. This includes business trips. Here, the duration of the business trip is not important. The A1 certificate has to be carried with you even for one-day business trips. In the case of an electronic filing of the application, the employer's operational processes have to ensure that business trips are managed in the payroll accounting system.

Recommendation: It is necessary to ensure that foreign postings are entered into the payroll accounting system fully and in good time, at the very latest, once the electronic filing of applications for A1 certificates has been set up.

StBin Sabine Rössler

Remuneration when equity interests in a GmbH are provided at a discount – Third-party benefits

» **Who for:** GmbHs (German limited companies) that provide benefits to their employees in the form of equity interests in order to retain them over the long term.

» **Issue:** The purchase of an equity interest in a GmbH at a discount by an executive employee can also result in this being treated as remuneration if it is not the employer him/herself who sells the equity interest but rather a partner of the employer. The Federal Fiscal Court (Bundesfinanzhof, BFH) recently decided this in its ruling from 15.3.2018 (case reference: VI R 8/16).

Firstly, in the relevant year, the claimant was hired by X-GmbH, based in Germany, as an officer holding a general power of attorney. He also held the position of managing director at an Austrian subsidiary of X-GmbH. In the course of a payroll tax external audit, which was carried out at X-GmbH, the local tax office concluded that the purchase price paid by the claimant for an equity interest that he had acquired in X-GmbH had not corresponded to the actual value of the equity interest. The difference was supposed to have been treated as taxable remuneration because the seller was the main partner in X-GmbH. The sale of the equity interest was related to the future deployment of the claimant as the 'Europe Manager' at X-GmbH.

The BFH thus confirmed that remuneration may be assumed also in the case of third-party benefits if it constitutes the consideration 'for' a service that the employee renders for the employer within the scope of his/her employment relationship. In the case in question, the acquisition of the equity interest was related to the employment relationship and the aim was to motivate the claimant to continue his commitment to the company and ensure his long-term loyalty. Here, the non-cash benefit that should be recognised as remuneration was not the transferred equity interest itself but rather the price reduction that was granted.

Please note: The value of a shareholding that is provided in a corporation should be derived primarily from sales in the normal course of business in arm's length transactions that took place less than one year ago (Section 11(2) sentence 2 of the German Valuation Act). However, as regards the sales in this case, there were already reasons to believe that objective measures of value for supply and demand had not been complied with. This is because with sales to employees there is a legal presumption that the agreements are (also) essentially related to the employment relationship. In such a case, the fair market value of the equity interest should be estimated.

FAStR Dr Carsten Dunkmann

LATEST REPORTS

'Excess withdrawals' from the perspective of tax on earnings – The Federal Fiscal Court provides for significantly more favourable treatment for taxpayers

From the perspective of tax on earnings, in accordance with Section 4(4a) of the German Income Tax Act (Einkommensteuergesetz, EStG), the deduction of debt interest is only possible to a limited extent. The underlying concept is easily understandable. A sum in the amount of 6% of the excess withdrawals – a maximum amount however of that debt interest that has not been incurred for the financing of capital assets reduced by a tax-free allowance of € 2,000 – may not be deducted. Excess withdrawals are deemed to exist if the withdrawals in a financial year exceed the profit plus any capital contributions, although excesses/ deficits in withdrawals from previous years are taken into account. Here, the tax authorities interpret the term 'profit' as 'profit or loss' and from this conclude that a loss can also result in excess withdrawals.

The Federal Fiscal Court (Bundesfinanzhof, BFH) clarified on 14.3.2018 (case reference: X R 17/16) that losses per se cannot result in excess withdrawals and that the assessment base for refusing the deduction of debt interest should thus generally be limited to the excess withdrawals over various periods. Therefore, non-deductible debt interest can only arise at most if the actual withdrawals exceed the capital contributions for the total period.

Income tax – Offsettable losses when part of an interest in a limited partnership is transferred

According to Section 15a(1) sentence 1 of the German Income Tax Act, a limited partner may not compensate the share of the loss from a limited partnership attributable to him/her either with other business income or income of any other kind if this gives rise to a negative capital account for the limited partner, or if this is increased. In this respect, the Federal Fiscal Court (Bundesfinanzhof, BFH) in its ruling from 1.3.2018 (case reference: IV R 16/15) decided that when a transfer of part of an interest in a limited partnership is made for no consideration then the offsettable loss can only be passed on to the acquirer if the related right to profits is also transferred.

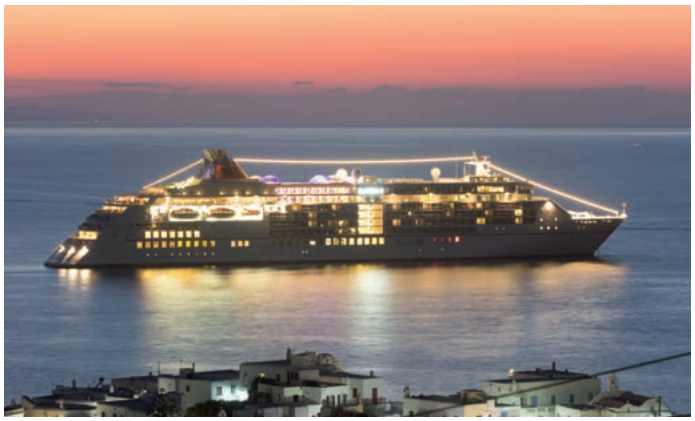
In the case in question, a husband had gifted his wife a part of his interest in a limited partnership. In the related contract of gift it was specified that the donor would retain the private account and that it would continue to be maintained by him. Withdrawals, capital contributions and profits were posted to this so-called capital account II.

Contrary to the opinion of the local tax office, the BFH confirmed the decision of the tax court to the effect that the transfer of offsettable losses had happened proportionally. The structures under civil law of the capital account transferred at the same time are not important but rather solely the transfer of the right to future profits. Therefore, in the case in question, the transfer of the proportional amount of limited partnership capital including offsettable losses took place. By way of explanation, the court stated that the acquiring wife is burdened because in the case of future profits, the negative capital account will have to be compensated again first of all.

New HEUBECK actuarial tables 2018 G

The new actuarial tables are based on the latest statistics from the German statutory pension scheme and the Federal Statistical Office; they take into account the most recent developments with respect to the probabilities of death, disability, marriage and fluctuation as well as, for the first time, the effects of socio-economic factors on life expectancy. These mortality tables are effectively applicable in Germany and it is also likely that the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) will officially recognise them for the tax-related measurement of pension provisions before the next

reporting season. Heubeck AG expects that in the tax accounts, depending on the composition of the portfolio, it will be necessary to make an allocation to pension provisions of 0.8% to 1.5%. For annual financial statements prepared in accordance with German/international accounting principles an increase of 1.5% to 2.5% is expected.



Travel companions are not relevant for gift tax purposes

Gift tax – A joint luxury cruise is not a taxable event

The Hamburg tax court, in its ruling from 12.6.2018 (case reference: 3 K 77/17) decided that giving someone the gift of a cruise does not give rise to a tax liability. In the case in question, the claimant had booked a five-month luxury cruise for himself and for his life partner. The price for a suite in the most expensive category on board was € 500,000 and this was irrespective of single or double occupancy. The local tax office asked the donor to submit a gift tax return. In this, the claimant declared a gift in the amount of € 25,000, which was attributable to the proportional cost of the journey to the destination, costs for excursions and meals for his life partner. By contrast, the local tax office wanted to levy gift tax on half of the overall costs plus the tax that had been assumed by the claimant.

However, in the view of the tax court, there had been no enrichment of the life partner as she had not acquired her own right to make a claim in relation to the travel service against the tour operator. Legally and effectively, a right to make a claim is not freely available if the service is provided solely in the context of joint consumption. Nor was the life partner's net worth increased by waiving compensation. A right to compensation for lost value would only have existed if the life partner had been spared her own costs. This is precluded if (as in the case in question) the life partner by herself would not have been able to cover the costs. Accompanying someone on a trip should be viewed as joint consumption and a kindness that is not relevant for gift tax purposes.

AND FINALLY...

"My future will always be linked to Fiat. This is my last job and I don't want to go anywhere else."

Sergio Marchionne, 17.6.1951 – 25.7.2018, Italian-Canadian manager/legend, reorganiser and CEO of Fiat Chrysler, Ferrari chief. The reorganisation of Fiat was his lifetime achievement. At the end of June 2018, the group was debt-free.

Impressum

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