PKF

Newsletter

Key Issue

Update on the planned obligation to disclose tax arrangements (DAC 6)

05|19

Dear Readers,

The OECD's BEPS action plan to combat tax evasion practices and profit shifting has frequently been the focus of our attention. At present, it is particularly action point 12, which concerns the disclosure of "aggressive tax planning", that is being transposed into national law. The German tax legislator apparently appreciated the **disclosure requirements with respect to tax planning arrangements** so greatly that it used the EU's Directive on Administrative Cooperation – called DAC 6 for short – as an opportunity to extend these, at the same time, similarly to (German) national tax arrangements. Moreover, it is not only tax consultants who are being targeted but rather also the tax departments of companies and, thus, their legal representatives who have to ensure that there is compliance. To this end, in the first article in our Tax section, which is simultaneously also our Key Issue for the May edition, we have provided an overview of the conditions under which disclosures have to be made and of the large number of criteria that will ultimately lead to a lot of discussions.

In our Tax section we subsequently discuss **tenant subsidies** and their income tax and VAT treatment, under which some leeway for structuring remains (which then hopefully will not also have to be disclosed). This is then followed by a report on the intricate to-ings and fro-ings between VAT and real estate transfer tax in a case where, ultimately, **partial double taxation** occurred. This was essentially something that precisely should not have actually happened.

We start off the Legal section with an overview of the new **German Trade Secrets Act**. This is likely to surprise through its greater hurdles that, from now on, will have to be cleared in order to obtain protection. On the other hand, deciphering another party's trade secrets – so-called reverse engineering – has been declared admissible. This overview is followed by guidelines on what should be borne in mind so that when **interns are employed** there is no violation of the minimum wage rules. Furthermore, we report on an important change in the law that should be observed if a staff member was already, at some point earlier, **employed at the same company**.

In the Accounting & Finance section, we take a look at the potentially clarifying amendments to IFRS for the measurement of **provisions for onerous contracts**. Apparently, international accounting standards essentially follow the full cost approach, which has been common practice under the German Commercial Code for some time. In another contribution, we provide an overview of the options for tax incentives that are planned in the area of research and development as of the coming year.

With our best wishes for an interesting read.

Your Team at PKF

Key Issue

Update on the planned obligation to disclose tax arrangements (DAC 6)

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TAX

StB [German tax consultant] Thorsten Haake

Update on the planned obligation to disclose tax arrangements (DAC 6)

EU member states are obliged to implement the requirements for the mandatory disclosure of cross-border tax arrangements by the end of 2019 and these regulations will then have to be complied with as of 1.7.2020. The legal basis for this is the sixth amendment to the EU mutual assistance directive 2011/16/EU, which came into force on 25.6.2018 ("Directive on Administrative Cooperation", or abbreviated to DAC 6). The Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* presented a draft bill from 30.1.2019 that regulates the implementation of the EU Directive into German law. However, the bill goes beyond the regulatory content of the EU Directive because domestic tax arrangements would also fall under the disclosure requirement. In the following section we give an overview of the planned new regulations together with initial recommendations for action.

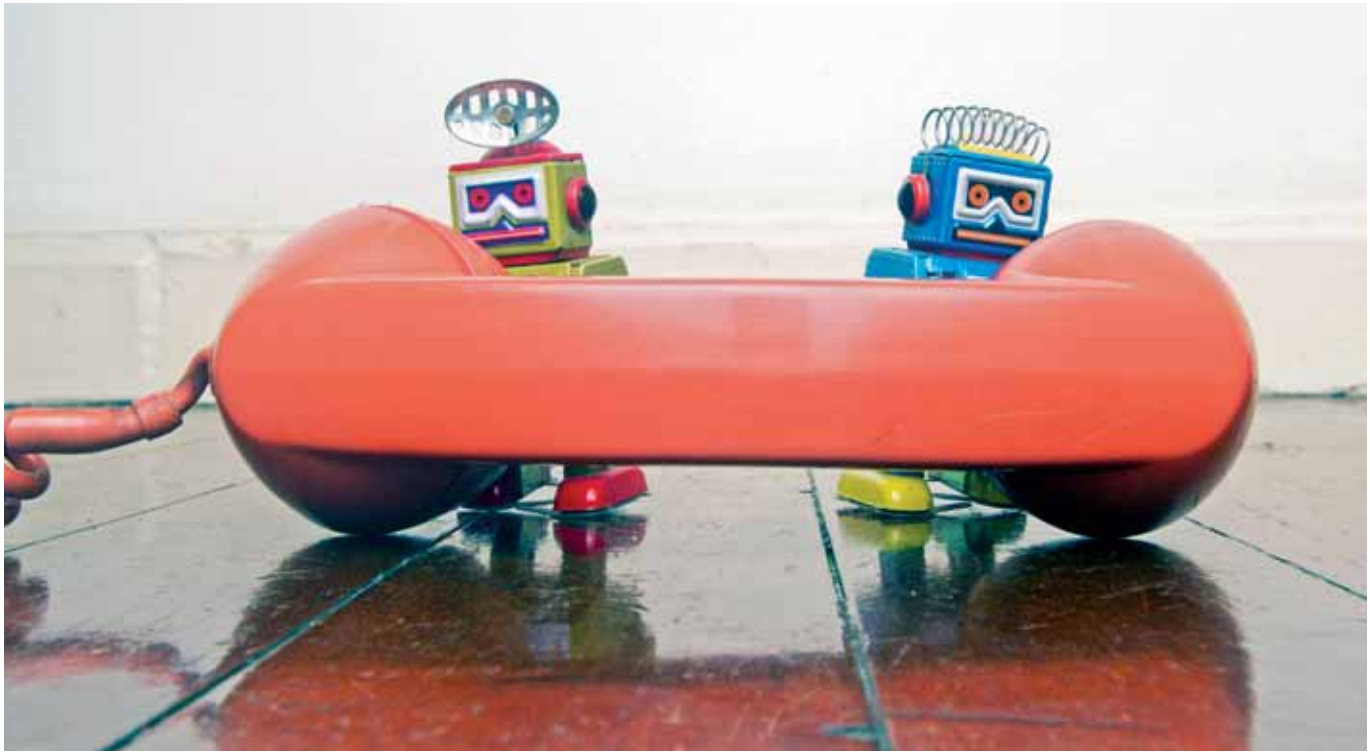
1. Objectives and solution from the point of view of the German legislator

The starting point for DAC 6 was action point 12 of the BEPS project, which focuses on the disclosure of "aggressive tax planning". According to the preamble to the law, the pursued aim of the transposition into German law is the prompt identification of and reduction in tax evasion practices and the shifting of profits with a view to preventing erosion of the German tax base.

Please note: Disclosures concerning cross-border tax arrangements are supposed to be exchanged between the EU Member States in an automated way. As a result, the respective legislators and tax authorities should be able to promptly identify tax practices and take action against them.

2. Who is obliged to file a disclosure?

The obligation to disclose applies primarily to so-called intermediaries. These could be, for one thing, tax consultants but also financial advisers (banks, insurance companies, etc.) and, ultimately, also the tax departments at corporations if they work for other group companies. According to the legal definition, an intermediary is any person that "markets a cross-border tax arrangement,



designs, organises or makes an arrangement available for implementation for third parties, or manages the implementation of an arrangement by third parties."

If the user of a cross-border tax arrangement has designed it for itself then the rules that apply to intermediaries shall accordingly apply to the user.

The disclosure obligation shall exist only for persons and corporations that are resident in Germany for tax purposes, i.e. they are domiciled or ordinarily resident in Germany, or the management or registered office are based there. German permanent establishments shall also be subject to disclosure requirements if they provide services related to tax arrangements. By contrast, it will make no difference if the user of a tax arrangement is resident in Germany or if the tax arrangement affects German tax claims.

3. When will a cross-border tax arrangement be deemed to exist?

A cross-border tax arrangement shall be deemed to exist if, cumulatively,

- the taxes involved are ones to which the EU Administrative Assistance Act applies (in particular, income tax, corporation tax and trade tax as well as inheritance and gift taxes, not however, e.g., VAT or import duty),
- several EU member states or one EU member state and one or more third countries are involved and
- at least one "hallmark of cross-border tax arrangements" is present.

In turn, the **"hallmarks of cross-border tax arrangements"** are divided into two groups.

Hallmarks of the first group are:

- agreement of a confidentiality clause or performance-related remuneration;
- standardised documentation or structure for the tax arrangement;
- one out of a total of five structuring variants described in more detail (use of losses, reclassification of income, circular transactions, integration of tax havens, use of preferential tax regimes).

Please note: However, a hallmark from this group is only relevant if the main benefit consists in obtaining a tax advantage. No disclosure is required if it can be demonstrated that tax advantages are not included among the main benefits of the arrangement (**"main benefit test"**).

Hallmarks of the second group are arrangements

- that take particular advantage of the residency in non-cooperative jurisdictions of recipients of the payments,
- with the aim of deducting depreciation several times or generating "white income" (i.e. income taxed in no jurisdiction),
- with which disclosure obligations for financial accounts are bypassed,
- with which the identity of beneficial owners as well as
- specific transfer pricing practices are obfuscated.

If one of the hallmarks from the second group is met then there will be no possibility to provide evidence to the contrary.

4. How does the disclosure procedure work?

The disclosure has to be made to the Federal Central Tax Office *(Bundeszentralamt für Steuern, BZSt)* using an officially prescribed set of data. The time limit is 30 days after the end of the day on which one of the following events occurred:

- the cross-border tax arrangement was made available for implementation,
- the user was ready to implement the cross-border tax arrangement, or
- the user made the first step to implement the cross-border tax arrangement.

The disclosure requirement is divided into two stages as follows. The **intermediary-related disclosure** covers personal data as well as details about the cross-border tax arrangement. After receipt of the disclosure, the BZSt then assigns a registration number to this disclosure and the intermediary has to immediately notify the user of the arrangement of this number. A distinction has to be made here between a **user-related disclosure**. This covers, among other things, personal data about the user as well as other persons or corporations involved; the disclosure should include the economic value of the arrangement and the date of the first implementation step.

Please note: If the intermediary is subject to a statutory confidentiality obligation (e.g. as a tax consultant) and if the user has not released the intermediary from this obligation then the disclosure obligation with respect to the user-related data will pass to the user.

5. What particularities should be taken into account in the case of (German) domestic tax arrangements?

The obligation to disclose domestic tax arrangements

only covers personal data about the intermediary as well as the details about the tax arrangement. The taxes involved are those related to income and capital, trade tax, inheritance and gift taxes as well as real estate transfer tax. The hallmarks of a domestic tax arrangement are based on those hallmarks in the first group for cross-border tax arrangements. A disclosure obligation for a tax arrangement only exists if the main benefit or one of the main benefits consists in obtaining a tax advantage. Unlike in the case of cross-border tax arrangements, no international exchange of information will take place.

6. When does the disclosure obligation come into effect and what will be the sanctions for non-compliance?

The disclosure obligations for cross-border tax arrangements shall apply to all cases where the first step was implemented after the 24.6.2018. If the first step is implemented prior to 1.7.2020 then the deadline for disclosures will be until 31.8.2020. For arrangements where the first step is implemented after 30.6.2020 a 30-day deadline for disclosures shall apply.

Please note: The obligation to disclose domestic tax arrangements will only come into effect for arrangements where the first step is implemented after 30.6.2020. Here, too, the 30-day disclosure deadline will apply.

In the case of wilful or negligent non-compliance or late compliance with the disclosure requirements, or if incomplete data are transmitted, a fine of up to € 25,000 may be imposed. However, this will only apply to arrangements where the first step is implemented after 30.6.2020.

7. Initial assessment and need for action

The rules contained in the draft bill are very comprehensive and detailed. In view of the use of numerous indeterminate legal concepts there will inevitably be

- difficulties in identifying both intermediaries and the arrangements that are subject to disclosure requirements
- as well as determining the events that trigger time limits for disclosure.

Moreover, the expansion of the scope of application to self-developed arrangements as well as domestic arrangements should not be underestimated. The situation will be exacerbated by the relatively short deadline for making disclosures as well as the threat of fines.

Please note: Furthermore, it should be noted that the disclosure obligation already applies to cross-border tax arrangements where the first step was implemented after the 24.6.2018.

Recommendation

In view of the retroactive effect, you should check now already whether or not arrangements that are subject to disclosure requirements currently exist or are at the planning stage. In this way, the requisite information could soon be collected or, alternatively, it could still be possible to exert influence over arrangements so that these do not fall under the disclosure obligation (e.g. by carrying out and documenting a “main benefit test”). Our PKF experts would be pleased to advise you in this respect.

RAin/StBin [German lawyer/tax consultant] Antje Ahlert

Income tax and VAT treatment of subsidies from a landlord for modifications made by a tenant

Granting rent-free periods is a popular means for inducing tenants to enter into contracts. The same applies to the granting of subsidies. Landlord subsidies should give tenants the option to make modifications in order to, e.g., adapt the sales area for the presentation of their products.

1. Classification for income tax purposes

For income tax purposes a distinction has to be made by subsidy providers as to whether their types of income constitute surplus income or profit income. If they have surplus income then the subsidies have to be deducted as costs related to letting and leasing, or spread evenly over the term of the rental agreement.

If a reporting company elects to provide a subsidy then it has to be allocated to the pre-paid expenses item and then reversed, thus reducing profits, over the term of the rental agreement. This solution is in line with the expanded

interpretation of Section 250 of the Commercial Code *(Handelsgesetzbuch, HGB)* and the view expressed in financial court rulings. Such an outcome is also in keeping with the economic intention because the parties wish to adjust the rent over the term of the agreement.

2. VAT treatment

If landlords have opted to charge VAT when they rent out their properties then, within the scope of the VAT treatment, a distinction has to be made as to whether the landlord subsidies constitute paid services or the subsidies should be treated as anticipated rent reductions.

In the case of a reduction in rent, the landlord subsidy would have the effect of reducing the payments. Here, the level of and/or the reduction in the assessment base would have to be viewed in the context of the partial services performed monthly. Taking into account negative revenue in the amount of the entire landlord subsidy in the first month is ruled out. The upshot is that until the amount of the landlord subsidy is reached no tax arises for the landlord. Consequently, pursuant to Section 15(1) clause 1 no. 1 clause 1 of the VAT Act *(Umsatzsteuergesetz, UStG)*, the tenant is likewise not authorised to make input tax deductions from the building works.

If the subsidy is deemed to be a paid service then this will be subject to VAT on the date it is provided. The tenant as the supplier of the service has to forward the VAT and the landlord can deduct the input tax accordingly.

Recommendation

A landlord subsidy can be advantageous for both parties. However, with a view to avoiding undesired consequences, when drafting the contract it has to be made clear whether the there will be a reduction in payments or a subsidy. Moreover, it should be noted that there could be a divergence in the income tax and VAT treatment.

RA [German lawyer] Dr Michael Rutemöller

Double taxation in the case of atypical estate agent contracts

Intermediary services provided within the framework of a taxable atypical estate agent contract in accordance with Section 1(2) of the Real Estate Transfer Tax Act *(Grunderwerbsteuergesetz, GrEStG)* do not satisfy the conditions under Section 4 no. 9(a) of the VAT Act *(Umsatzsteuergesetz, UStG)* and are, therefore, also subject to a VAT liability. Double taxation of income with VAT and real estate transfer tax (RETT) is the consequence.

1. Issue: Working as an atypical estate agent

The Federal Fiscal Court *(Bundesfinanzhof, BFH)*, in 2015 already, dealt with the issue of the relationship between VAT and RETT in the case of an intermediary service provided by an atypical estate agent with exploitation rights. This issue is currently still relevant in the flourishing property market. In the case requiring clarification, the claimant as an atypical estate agent gave an undertaking to property owners to sell their privately owned flats on their behalf at a minimum selling price. The amount that exceeded the minimum selling price would be payable to the agent as a sales fee. In order to be able to carry out this remit the claimant obtained selling rights and the authorisation to transact the sales. The purchase price was supposed to be transferred by the buyers directly to the property owners. In this case, the owners were supposed to retain the minimum selling price and transfer the excess amount to the estate agent.

The local tax office took the view that the atypical estate agent had provided a taxable service to the owners in accordance with Section 1(2) GrEStG. In the relevant year, the property owners received an invoice for the intermediary commission (the basis of assessment was the difference between the fixed minimum selling price and the actual purchase price). VAT was not shown separately on the invoice but, instead, there was simply a reference to the tax exemption in accordance with Section 4 no. 9(a) UStG.

2. No VAT exemption ...

The BFH, in its ruling from 10.9.2015 (case reference: V R 41/14), upheld the views of the court of first instance

as well as those of the defendant tax office and refused to allow the VAT exemption for the intermediary service in accordance with Section 4 no. 9(a) UStG that the claimant had claimed in the context of the atypical estate agent contract without prejudice to the tax liability that already existed under Section 1(2) GrEStG.

... despite an existing RETT liability

Legal transactions that enable others legally or economically to dispose of land and property in Germany for their own accounts, without establishing a right to transfer ownership, are also subject to RETT under Section 1(2) GrEStG. The BFH also applies this provision to legal transactions where atypical estate agents obtain a legal status in intermediary contracts with respect to property ownership that gives them the possibility of participating in the value of the land and property (e.g. within the framework of an intermediary commission). In the case in question, in view of the exploitation rights that were granted in the atypical estate agent contract with respect to the land and property these conditions were met. The consideration paid by the buyer for the purchase of the land and property was thus subject to RETT.

Please note: According to the BFH, the claimant's business activity meant that she had provided a service that was liable to VAT. Section 4 no. 9(a) UStG exempts from VAT only those transactions that fall under the GrEStG. The intermediary service in question here was as such based on an intermediary contract and as a miscellaneous service it is precisely not subject to RETT.

Conclusion

Generally, legal transactions that trigger VAT as well as RETT should be considered separately. Moreover, under EU law there is also no reason to question the double taxation, with VAT and RETT, of the services provided by the claimant. The ECJ, in its decision from 2008 (case reference: C-156/08) expressly ruled that RETT cannot be characterised as VAT and, therefore, there can be no double taxation in violation of European law.

LEGAL

RA [German lawyer] Sebastian Thiel

New standards for the protection of trade secrets

In order to implement the EU Trade Secrets Directive the German Bundesrat (upper house of German parliament) approved the Trade Secrets Act *(Geschäftsgeheimnisgesetz, GeschGehG)* on 12.4.2019; thus, the promulgation and the entry into force of the act will take place soon. The Act will be of great importance for enterprises that gain advantages over their competitors in the market on the basis of specific technical or commercial knowledge and thus rely on the protection of these business and trade secrets. In order to obtain protection under GeschGehG the enterprises will have to comply with considerably more stringent requirements. Furthermore, deciphering trade secrets – so-called reverse engineering – from products has been declared admissible for the first time.

1. Trade Secrets Act – New Regulations

The aims of the act are to protect against trade secrets being illegally obtained, illegally used and illegally disclosed as well as to have comprehensive rules in a special central law. The criminal provisions hitherto defined in the German Act Against Unfair Competition will in future be codified in the GeschGehG. Here, the Act provides for improved procedural means for the protection of trade and business secrets in civil proceedings.

Please note: Up to now, trade secret protection was regulated by general standards in the German Civil Code and, from now on, the provisions of the special Act are envisaged. Besides the entitlement to damages, removal and injunction, the right to destruction, surrender, recall as well as information have moreover been enshrined in the GeschGehG.

2. Permitted activity – reverse engineering

Unlike previously under German law, GeschGehG spe-

cifically states that reverse engineering constitutes a permitted activity. Accordingly, in future it will be possible to obtain trade secrets through observation, study, disassembly or testing of a product that is publicly available or that is lawfully in the possession of the person conducting the above activities.

Recommendation: It is possible to contractually exclude reverse engineering in relation to contractual partners and this is indeed recommended. In particular, framework contracts and cooperation agreements and also GTC should therefore be checked and, if necessary, adjusted.

3. Amended definition of a trade secret

A key change in relation to the previous legal situation consists in the new definition of a "trade secret" according to Section 2(1) GeschGehG. In view of the stricter requirements there will possibly be a narrower scope of protection than previously. This is because, from now on, the elements that constitute a trade secret should presuppose, among other things, that the information "has been subject to adequate confidentiality measures, under the circumstances, taken by its legitimate holder. Moreover, the information has to be secret to a certain degree and have a "commercial value".

If enterprises wish to benefit in the future from the protection available under the GeschGehG then they will have to take proactive and ongoing measures to maintain confidentiality in an "adequate" manner. Firstly, this relates particularly to protecting secrets via confidentiality agreements with business partners (so-called non-disclosure agreements, NDA) and declarations of secrecy signed by your own staff. Furthermore, enterprises have to ensure an adequate level of IT security. The above-mentioned aspects – especially the latter – are frequently underestimated.

Recommendation

If no confidentiality measures have been taken up to now, or if these no longer comply with the latest established case law or state-of-the-art, there is a risk that the measures would not be deemed to be adequate within the meaning of Section 2(1) GeschGehG. The protection of trade secrets under civil law would only apply at all if an enterprise were able to provide evidence in legal proceedings that it has adequate protection for its trade secrets.

RAin [German lawyer] Maha Steinfeld

(No) time limitation of an employment contract in the case of previous employment

Under the law, fixed-term contracts without a material reason are permissible for a period of up to two years. However, they are inadmissible if a fixed-term or permanent employment relationship had already existed previously with the same employer (pre-employment prohibition). The aim of the prohibition is to prevent chains of fixed-term contracts in particular. An infringement of the prohibition would result in the unenforceability of the time limitation so that the employment contract would be deemed to be a permanent one.

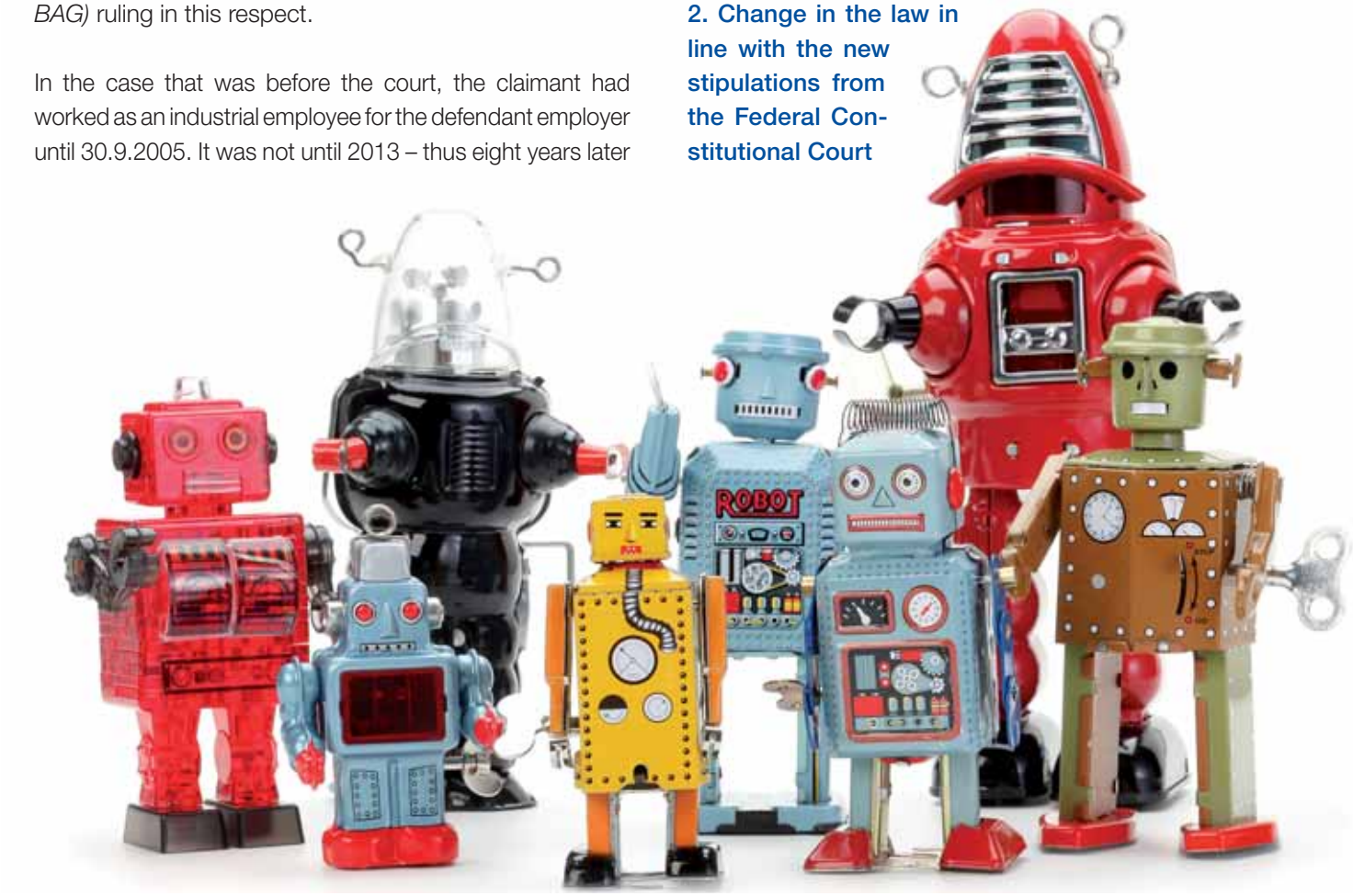
1. Pre-employment prohibition under review at the Federal Labour Court

The question that arises with respect to the pre-employment prohibition is for how long should past pre-employment with the same employer be regarded as detrimental from a time limitation perspective and, in particular, whether or not the prohibition is applicable even if the pre-employment was a very long time ago. This is an issue that is of practical relevance and there is now a recent Federal Labour Court *(Bundesarbeitsgericht, BAG)* ruling in this respect.

In the case that was before the court, the claimant had worked as an industrial employee for the defendant employer until 30.9.2005. It was not until 2013 – thus eight years later – that the defendant had once again employed the claimant as a technician on a fixed-term contract without a material reason. The parties extended the term of the contract a number of times, in a final step until 18.8.2015. When the employer no longer wished to continue the employment relationship with the claimant the employee brought an action for the continued existence of the employment relationship. He argued that the pre-employment prohibition precluded a time limit – and he was successful.

This was because, according to the BAG ruling, the regulation on the pre-employment prohibition (Section 14(2) clause 2 of the German Part-Time Work and Fixed-Term Contracts Act) is applicable. Thus, the time limitation to the employment relationship with the employee was unenforceable on account of the employment relationship with the employer that had been terminated eight years ago already. In 2011, the BAG had still ruled that this norm did not cover such previous jobs that were more than three years in the past. According to that ruling, in the case in question, the time limitation would have been valid.

2. Change in the law in line with the new stipulations from the Federal Constitutional Court



The Federal Constitutional Court *(Bundesverfassungsgericht, BVerfG)* however ruled, on 6.6.2018, that the three-year limit for the pre-employment prohibition could not be applied across-the-board (proceedings with the case reference: 1 BvL 7/14, 1 BvR 1375/14). The pre-employment prohibition generally fully applies and restrictions should only be imposed in exceptional cases. Since then it has been unclear how the pre-employment prohibition should be understood in practice. Against this background, the BAG, in its ruling from 23.1.2019 (case reference: 7 AZR 733/16) has now decided that, in any case, the pre-employment prohibition shall also apply if the previous employment relationship was eight years ago.

3. Conclusion

In accordance with the stipulations of the BVerfG, restrictions should only be imposed on the pre-employment prohibition if this is regarded as being unreasonable for the employer, in particular if

- the previous employment was a very long time ago,
- it was completely different,
- or it was of very short duration.

Specific time limits from the BVerfG were lacking. This BAG ruling now provides an initial basis in this regard.

Recommendation

For employers the new ruling means that prior to employing a (new) staff member on a fixed-term contract without a material reason they should always carefully check whether or not there has already (ever) been an employment relationship with this employee.

RAin [German lawyer] Yvonne Sinram

The latest on the minimum wage during internships

The Minimum Wage Act is still keeping the labour courts busy. A question that arises in practice is what are the conditions under which interns are entitled to the minimum wage. While the remuneration of work performed is not consistent with the basic concept of an internship, up to now, remuneration has frequently already been paid here. However, it was only in the rarest of cases that this reached the level of the minimum wage, which was raised to € 9.19 per hour at the start of the year. Clarifying the situation is thus of some relevance for businesses and it is not always easy to do this.

1. Differences depending on the type of internship

So-called mandatory internships are not affected by the minimum wage. These are internships that have to be compulsorily undertaken (e.g. because of the legal regulations of colleges and universities). The duration of the internship does not matter here.

There are greater difficulties with voluntary internships. These are exempt from the minimum wage if they

- are undertaken for orientation purposes with respect to vocational training or beginning a course of study, or
- are undertaken during vocational training or a university course if such an internship relationship did not previously exist with the same company and
- the internship does not last longer than three months in each case.

2. The Federal Labour Court *(Bundesarbeitsgericht, BAG)* has rejected the notion that the maximum duration can be exceeded in the event of interruptions

On the issue of the maximum duration of three months, the BAG has now made an important clarification to the effect that interruptions to an internship should not be included when calculating its duration. In any case, this applies if the reasons for the interruption lie in the intern's personal sphere and there is neither a substantive nor a temporal connection that can be affirmed for the entire internship.

This was also the situation in the case in question. There, the internship was interrupted – partly because of sickness and partly at the request of the intern – for a total of about three weeks and, subsequently, extended by this period. As the actual duration of three months was in effect not exceeded, ultimately, the court rejected the intern's minimum wage claim (for roughly € 5,500) (ruling from 30.1.2019, case reference: 5 AZR 556/17).

Please note: When interns are employed, besides the minimum wage problem, frequently there is also the issue of the assessment of such employment in relation to social security law. Apart from the distinction between mandatory and voluntary internships, many other factors can play a role here.

If you are in any doubt then please do not hesitate to contact your PKF consultant.

ACCOUNTING & FINANCE

StB [German tax consultant] Tim Guschl

The accounting treatment under IFRS of provisions for onerous contracts with customers

According to IAS 37, provisions have to be created for onerous contracts with customers. Such a contract would be deemed to exist if the unavoidable costs of fulfilling the contract were higher than the expected economic benefits. In order to specify the scope of these costs, on 13.12.2018, the International Accounting Standards Board (IASB), in its Exposure Draft ED/2018/2 Onerous Contracts – Cost of Fulfilling a Contract, proposed appropriate amendments to IAS 37.

1. Reason

Examinations of practice by the IFRS Interpretations Committee had shown that there were different approaches to assessing whether or not a contract was onerous.

- On the one hand, there were interpretations discernible under which all costs that related to the contract were included.
- On the other hand, the concept of unavoidable costs was interpreted in such a way that solely incremental costs were taken into consideration, i.e. only those costs that would not be incurred without the contract.

2. Draft amendments to IAS 37

The draft amendments to IAS 37 made by the IASB now provide that all costs that directly affect the contract will be regarded as costs of fulfilling the contract. Thus, the incremental costs as well as other costs directly related to the contract will be taken into account.

Please note: There was a possibility to comment on ED/2018/2 up to 15.4.2019. On the basis of the comments received, the IASB should now be able to move forward with its proposal. The draft is available online at www.ifrs.org.

The following examples of costs that would relate directly to a contract are listed in the draft:

- direct personnel costs (e.g. wages and salaries of those employees who undertake the manufacture or delivery or who provide a service directly to the customer);
- direct material costs (e.g. supplies used in fulfilling the contract);
- overhead expenses that relate directly to the contract activities (e.g. costs of contract management and supervision; insurance and depreciation of tools, equipment or rights-of-use assets used in fulfilling the contract);
- costs explicitly chargeable to the customer under the contract;
- other costs incurred only because the contract was concluded (e.g. payments to subcontractors).

By contrast, general administrative costs should only be taken into account if they are explicitly passed on to the customer.

3. Implications for accounting practice

If it has hitherto been assumed that solely incremental costs should be taken into account then the planned change would result in contracts with customers having to be classed as onerous at an earlier stage and, thus, the creation of a provision would be more likely.

In the opinion of the IASB, the amendments permit a more realistic representation of the fulfilment of a contract. Moreover, this is also consistent with the prevailing opinion in commentary literature in the German-speaking region according to which the full cost approach is deemed to be the only standard-compliant solution.

Conclusion

As expenses that are expected still to be incurred for pending transactions should generally, according to the Commercial Code (Handelsgesetzbuch, HGB), also be recognised at full cost (see German Accounting Standard of the Auditing and Accounting Board "IDW RS HFA 4"), this clarification is likely to lead to the alignment of the IFRS interpretation with that of HGB even if the concepts are not always identical.

StBin [German tax consultant] Daniela Hiller

Tax incentives for research projects from 2020

In order for German companies to be better able to keep up with innovation in the face of international competition many politicians from various parties have been calling for tax incentives for research and development projects. One such incentive was already set up in the coalition agreement. The Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* has now compiled a "draft discussion document" for a tax incentive scheme for research and development projects.

1. Eligible projects

The Federal Ministry of Finance has planned to make an amount of about € five bn available in grants for the new legislation. The aim is to provide support for research and development projects, such as, e.g., projects relating to basic research, industrial research and experimental development. Subsidies will also be available for contract research; although, as solely the personnel costs will be included in the assessment basis for calculating grants it will be the contractor and not however the principal that will be entitled to a grant.

Please note: Joint projects by companies that, for example, join forces with research institutes would also be eligible for support.

2. Amount of grant

The grant will amount to 25% of the wages and salaries of the staff involved in the research project. However, as the assessment basis will be limited to € 2m, the maximum possible grant will be in the amount of € 500,000. All the companies in an affiliated group will be included in the calculation for the upper limit.

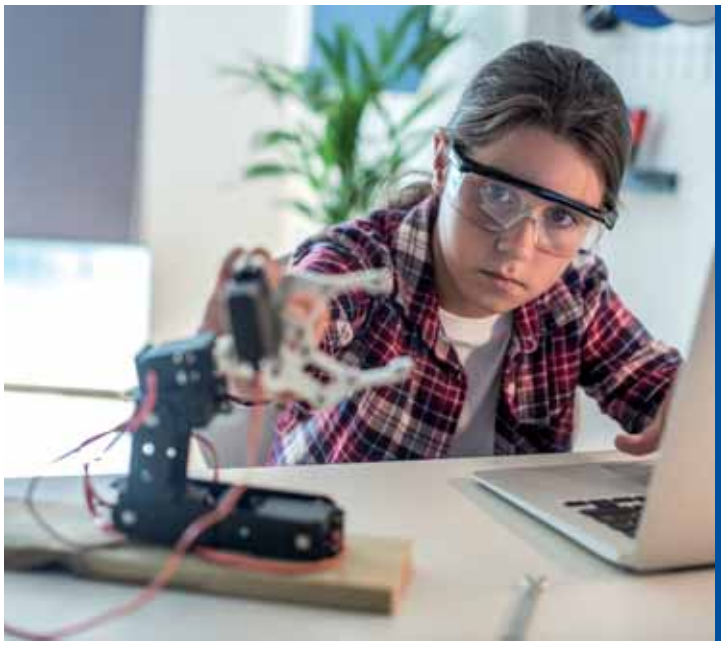
Companies will be able to access the grants for project costs for the first time from 2020. The current version of the draft provides for a time limit of four years. A prerequisite for the receipt of a grant is to make the respective application after the end of the financial year in which the expenses were incurred.

Please note: Companies will therefore not be able to get around pre-financing the costs to begin with.

3. Benefiting companies

According to the draft discussion document, the grant will be basically available to all companies, irrespective of their size. A restriction of the grants to small and medium-sized enterprises (SME), which some of the parties had been calling for, is thus not in the proposal by the BMF. Treating all companies equally here has aroused criticism that the grants could become tax giveaways for large companies.

Please note: It is thus likely that this aspect, in particular, will still be the focus of intense debate prior to the passage of the legislation.



Outlook

Germany competes internationally in the promotion of research where various east European countries rely on higher levels of / accelerated depreciation while west European states tend to grant tax benefits by way of subsidies. Ultimately, the exact form the tax incentives will take in Germany will become apparent only gradually because the draft presented by the BMF has evidently not yet been agreed among the coalition parties or the Federal Ministry for Economic Affairs and Research.

LATEST REPORTS

RA/StB [German lawyer/tax consultant] Frank Moormann

Exclusion clauses in employment contracts may not apply to the minimum wage

Pre-formulated employment contracts frequently contain so-called exclusion clauses under which mutual claims of the parties are forfeited if they are not asserted or sued for within a certain period of time. The aim of these is to quickly bring about legal certainty in the employment relationship by bypassing the statutory limitation period. However, such clauses have to expressly exclude the forfeiture of claims under the Minimum Wage Act *(Mindestlohngesetz, MiLoG)*. Otherwise the clauses would be completely unenforceable because of an infringement of the transparency requirement and, in any case, if the employment contract was concluded after 31.12.2014. This had already become apparent and has now been clarified by the German Federal Labour Court in its ruling from 18.9.2018 (case reference: 9 AZR 162/18). Old contracts that were concluded before the MiLoG came into force (on 16.8.2014) benefit from grandfathering. They likewise do not cover claims that fall under the Minimum Wage Act, nevertheless, they remain enforceable in all other respects.

Please note: It is still unclear whether or not this likewise applies to contracts that were concluded in the period between the coming into force of the Act and when the claim first arose (1.1.2015). Moreover, the subsequent modification of an old contract could be problematic if the exclusion clause is not adjusted in the course of this.

StBin [German tax consultant] Sabine Rössler

Reinvestment is required prior to the transfer of a Section 6b reserve

An isolated transfer of a reserve pursuant to Section 6b of the German Income Tax Act *(Einkommenssteuergesetz, EStG)* into another of the taxpayer's businesses was not permitted because this does not have the nature of a capital asset without the simultaneous deduction of purchase or production costs for a qualifying capital asset – this was recently decided by the Federal Fiscal Court in its ruling from 22.11.2018 (case reference: VI R 50/16). In fact, according to this ruling, a reserve created pursuant to Section 6b(3) EStG can only be transferred to another business in the financial year in which the deduction of purchase or production costs for capital assets of the other business is made. Otherwise, the reversal of the reserve would not be the decision of the business that had created it but rather that of the one that reinvests the reserve.

Please note: This ruling has confirmed the requirements of the tax authorities in the Income Tax Guidelines (Guideline Section 6b(2)).

WP/StB [German public auditor/ tax consultant] Dr. Matthias Heinrich/ [Tax consultant] Julia Hellwig

Travel costs when using public transport – The flat rate per km does not apply

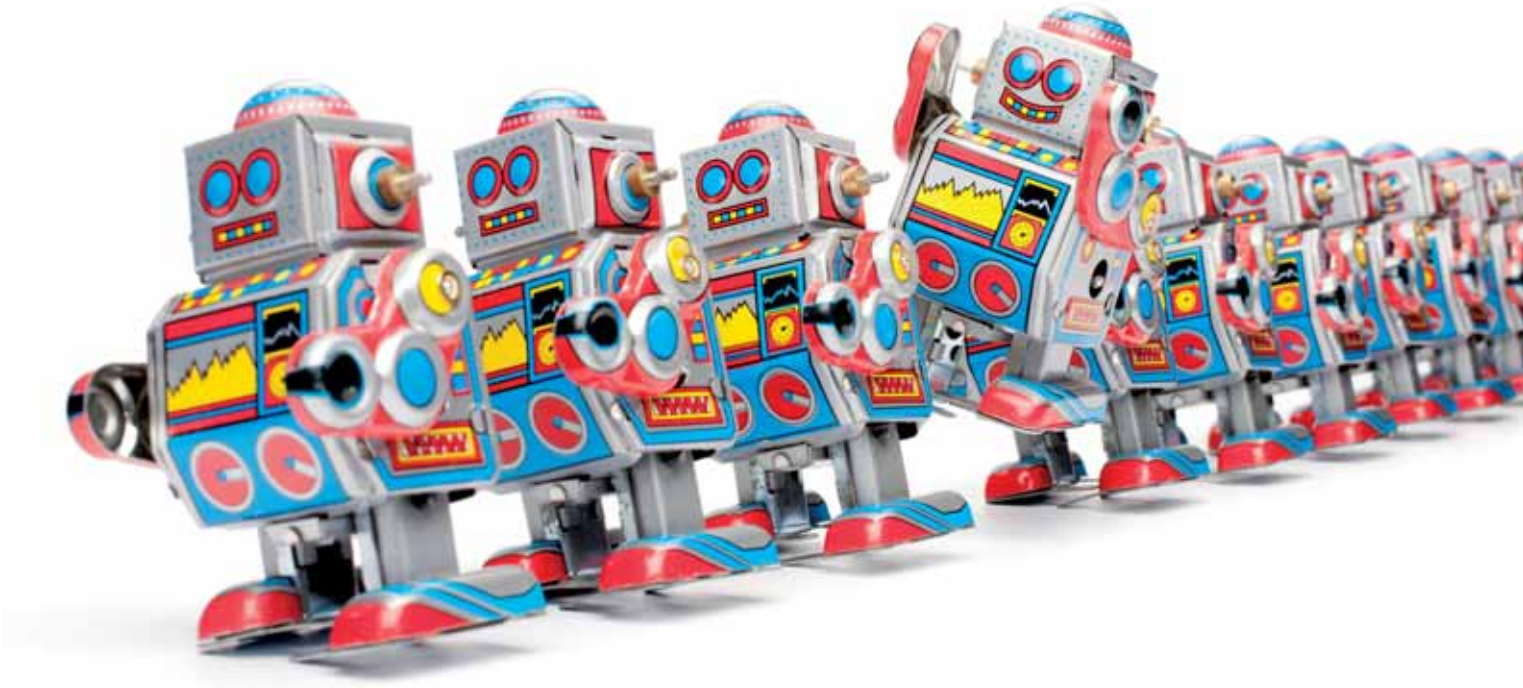
For work-related trips that do not constitute journeys between the home and the primary workplace location, or journeys back to the family home, employees may deduct as work-related costs, instead of the actual costs incurred for using a means of transport, the generally higher flat rates in accordance with the Federal Travel Expenses Act. This does not however apply in cases where public transport is used. The Hamburg tax court, in its ruling from 2.11.2018 (case reference: 5 K 99/16), confirmed the decision of a local tax office not

to take into account the reduced flat rate that had been claimed.

In the case that was considered, a taxpayer regularly travelled by train as part of his field service and his employer reimbursed his travel costs to him. With reference to the provision described above and after subtracting the reimbursements from his employer, the taxpayer claimed a flat rate of € 0.20 per kilometre and day.

The tax court explained that a higher distance allowance could only be claimed in the case of personally driven vehicles. This is because in the case of public transport (train, bus, plane, ship) it is usually possible to verify the costs that were incurred. Furthermore, the taxpayer would actually have to have been burdened with costs. This was not the case given that the employer had fully reimbursed all the travel costs.

Please note: An appeal has been lodged with the Federal Fiscal Court against this decision (case reference: VI R 50/18); further developments remain to be seen.



StBin [German tax consultant] Sabine Rössler

Merger gains in a group of companies consolidated for tax purposes – No general prohibition on tax deduction

The Federal Fiscal Court, in its ruling from 23.10.2018 (case reference: I R 74/16), decided that taking into account a flat rate of 5% as a non-deductible business expense (Section 8b(3) clause 1 of the German Corporation Tax Act *(Körperschaftsteuergesetz, KStG)* should not apply to a gain that results from a merger of a corporation with its parent company which is concurrently a subsidiary company of the fiscal unity parent corporation.

In the opinion of the judges at the supreme tax court, the so-called gross method should not be applied in the case of a merger gain from a subsidiary company. On that point it was further argued that a transfer profit pursuant to Section 12(2) clause 1 of the German Reorganisation Tax Act 2006 should already be exempted prior to this when determining the income attributable to the parent company so that it is not even 'contained' in the income from the subsidiary company that is attributable to the parent company pursuant to Section 14(1) clause 1 KStG that should be checked for issues relating to Section 8b KStG.

Please note: This ruling, which is favourable for taxpayers, contrasts with the opinion of the tax authorities in the marginal note 12.07 of the German Reorganisation Tax Decree from 11.11.2011.

AND FINALLY...

"I am and will remain a tax resident in France and in this regard I will, like all French people, fulfil my fiscal obligations."

Bernard Arnault, born 5.3.1949, French entrepreneur, wants to donate € 200 m for the reconstruction of Notre Dame

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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