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Tax & Legal News

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Issue 2
February 21, 2013

pwc

PwC Reports

Corporation tax on portfolio dividends

In October 2011, the ECJ held in a suit against Germany brought by the European Commission that the German withholding tax on dividends to EU and foreign corporations was in breach of the free movement of capital (case C-284/09). Its main point was that the system discriminated against foreign corporations as minority shareholders inasmuch as the dividend withholding tax of 15% plus solidarity surcharge (or lower treaty rate) was effectively a final burden for them, at least from the German point of view, whereas a German corporation in an otherwise similar position would always be entitled to a refund of the amount deducted. The mechanism was simple: the withholding tax was effectively a payment on account of the corporation tax due although dividend income was generally free of corporation tax, the one exception being dividends received by banks on securities held for trading. A resident corporation would therefore always be entitled to credit or reimbursement of any withholding tax borne. Since dividends on strategic holdings of 10% or more generally fall under the Parent/Subsidiary Directive exemption if paid to a corporate shareholder in another EU member state, the discrimination essentially caught portfolio holdings of less than 10% of the share capital of the dividend payer. The judgment left Germany the choice between rendering all portfolio dividends chargeable to corporation tax and waiving the withholding tax on those paid to corporate shareholders abroad. After some debate, the government chose the former.

The bill has now received the blessing of the *Bundesrat* and so passed its last parliamentary hurdle. Its enactment into law is for all practical purposes now certain. It amends the Corporation Tax Act to charge all dividends received on or after March 1, 2013 on shareholdings of less than 10% of the paying company's share capital on the previous January 1 to corporation tax. However, acquisitions of more than 10% during the (calendar) year rank for this purpose as having been acquired as of the beginning of the year, so distributions immediately after a major share acquisition are not "caught". On the other hand, shares in the same company held by different members of a tax group are not added together, so groups with extensive and dispersed investments may need to reorganise their holdings.

It should also be noted that the Tax Act on Investment Funds has been amended to mirror the new liability. However, the corporation tax exemption for capital gains realised on the sale of shares has not been changed. The trade tax liability on dividend income on holdings of less than 15% also remains unchanged.

Official Pronouncements

Provision for future tax audit costs

In June 2012, the Supreme Tax Court held that a "large" business could generally reckon with a future tax audit covering all open years and was therefore to be allowed to take up a provision in its accounts for its expected costs to be incurred in meeting its duties to support the tax auditors. The finance ministry has now issued a decree accepting this judgment as a precedent and calling for it to be followed in all open cases. The judgment and the decree are based on the premise that all open years will be audited by the authorities and therefore apply to businesses classified as "large", that is, to businesses whose books and records for every year "should" be audited. A "large" business is defined by turnover or profit, the levels varying by activity. For example the 2013-15 annual levels for distributors are €7.3 m turnover or €280,000 profit and for manufacturers €4.3 m turnover or €250,000 profit. The costs to be provided are the direct costs of the business in meeting its obligations to support the tax auditors. These include legal and professional consultancy fees in this connection, but not the administrative expense of record retention, of preparing the annual accounts or of updating EDP systems to allow the tax auditors online access to data. The provision should include an appropriate allowance for general expenses, but must be discounted at 5.5% p.a. as a long term liability.

Valuation of emission certificates for pollutants

Companies with industrial processes potentially harmful to the environment are required to limit their emissions of carbon dioxide and similar pollutant gases to the quantities for which they hold emission certificates. Each qualifying company receives an initial allocation of certificates free of charge, but additional certificates needed must be purchased. Each certificate is cancelled as used. Unused certificates held on balance sheet date are to be valued at cost. This balance is to be determined on the basis of a specific identification of each certificate from its serial number or other ID. The finance ministry has now decreed that if specific identification is not possible, the certificates received free-of-charge shall be deemed to have been used first. Acquired certificates cannot therefore be taken to expense until the basic issue has been used.

Organisational integration for VAT groups newly defined

A VAT group (*Organschaft*) must meet three basic integration requirements, financial, commercial and organisational. Financial integration implies that the parent holds a majority in voting rights over the subsidiary, commercial integration means that the business of the subsidiary supports or complements that of the parent and organisational integration is held to exist where the subsidiary is unable to set its own management policy. The organisational integration requirement is sometimes expressed as the subsidiary's lack of a will of its own as distinct from that of the parent and has traditionally been seen as being met where both entities are managed by the same directors. However, the exact limits of this integration are not always clear and the finance ministry has now issued a decree setting out in some detail the principles to be followed.

Organisational integration is an extension of, but distinct from, financial integration in that it is the execution of the parent's powers of direction conferred by its majority vote. It must ensure that the subsidiary cannot develop a managerial will of its own. This is a question of fact. The primary example continues to be common directors, although it is not necessary for every director to hold office in both companies. Thus, not every director of the parent need serve on the board of the subsidiary. The position is more complicated where not all the directors of the subsidiary are also directors of the parent. In these cases, regard must be had to the powers of each individual. If the rights are exercised jointly, there will be organisational integration if the common directors of the subsidiary form a majority able to decide the issue under debate. If they cannot, organisational integration will require other institutional measures to prevent action by the subsidiary against the wishes of the parent. These can lie in the combination of extensive management rights of the parent with the power to appoint and dismiss the directors of the subsidiary. They can also lie in a (documented) mechanism forcing an independent director of the subsidiary to submit to resolution of a dispute by the common director appointed by the parent. The organisational integration can be indirect through intermediary companies, but cannot be through common supervisory board memberships. Organisational integration can also be founded by directors of the subsidiary, who are not, themselves directors of the parent. However, they should hold senior management positions with the parent and be bound to follow the instructions of their superiors on pain of loss of office with the subsidiary should they fail to do so. By contrast, it is not sufficient that an appointee of the parent merely hold a senior position with the subsidiary subordinate to a director answerable to the parent in the latter's capacity as shareholder only.

In exceptional cases, there may be organisational integration without common directorships. However, there must be institutional measures ensuring the obedience of the subsidiary's management to the will of the parent on all matters of importance. Examples can be found in a formal group policy, or in standing orders for management set specifically for the subsidiary. The parent's management must also be able to demonstrate its control over the subsidiary to third parties. This control must be exercised regularly; the ability to act as a majority shareholder, the establishment of a regular reporting system, approval requirements or consultancy bodies without their own executive power are, of themselves, insufficient.

The new definition is to apply to all open cases. However, no objection will be taken to companies continuing to follow the old definition for the remainder of the calendar year 2013, provided that all members of the group do so consistently.

Supreme Tax Court Cases

Provision for record retention costs can include interest

The Supreme Tax Court has previously held that a company faced with a statutory record retention requirement can take up a provision for those costs anticipated in respect of the records already existing. Other things being equal, it may be assumed at year-end that the remaining average retention span will be 5.5 years, based on a ten-year statutory period. It has now held that the costs to be taken into account are to be measured on a full costing basis and are to include reasonable interest on the cost of financing the facilities used. This interest expense can be general, that is, it is not restricted to that paid on a tied, or specific purpose, loan, although it must be verifiable as actual through a suitable costing system. If the financing is general, it can be allocated as a composite rate based on the company's interest expense on its total borrowing set in proportion to the ratio of loan finance to shareholder's equity. The amount, though, must be reasonable from the point of view of overall trading. This means that other, non-tax rules to with the company is subject should be taken into account. In the case at issue, a savings bank, a reasonable upper limit was that given by the solvability ratio to which the bank, in any case had to adhere.

Supreme Tax Court judgment I R 66/11 of October 11, 2012, published on February 27, 2013

No tax on off-balance sheet intangibles on change to tonnage tax

The German tonnage tax system allows shipping lines to determine their taxable income from the operations of their ships in international waterways on an almost invariably favourable formula based on the number of days at sea and the net register tonnage (a measure of a merchant ship's available space for passengers and cargo – 1 NRT = 2.83 m^3) of the ship. The option is exercised by ship at ten-yearly intervals, the first opportunity being the year in which the ship is put into service. On election for tonnage tax, the untaxed reserves accumulated in previous periods through the accretion in value of capital and other assets are established in a register comparing the book and market values of each item at the close of the immediately preceding business year. These reserves are then released to taxable income on disposal of the asset to which they relate, on withdrawal of that asset from international operations, or on election to return to regular taxation on the results for the vessel concerned.

A shipping line ordered a vessel from a shipyard in the USA for a fixed price for delivery in December, some 17 months later. The price was to be paid in instalments based on progress in construction. As things turned out, the ship was not completed until the following January, at which time the shipping line took possession and started the process of registration, fitting out and working up. At this stage, the line applied for approval to tax the ship's operations by "tonnage" (NRT). On approval, it drew up its register of hidden reserves (consisting entirely of exchange gains on its US $ prepayments, but offset by the losses on the corresponding liabilities). Some years later, the tax auditors noticed that the hidden reserve register made no mention of the rise in ship prices between the date the ship was ordered and the date the line took possession. In their view, the vessel acquired was worth more than the amount paid for it and this accretion in value should have been reflected in the schedule as an "order value".

The Supreme Tax Court has now held that the shipping line could not have taken up an "order value", as such an asset had not, and could have, been capitalised in the accounts prior to delivery of the ship. Rather, it was a contingent asset from unfinished business. If it could not be accounted for, it could not have a book value (the tax office claimed the book value was nil), which could not therefore be compared with a current market value. Accordingly, no hidden reserve could be registered.

The tax office then tried another tack by claiming the value of the prepayments had risen beyond their nominal amount. The thinking seems to have been, the ship had been almost completely paid for by the end of the year of valuation, so that in effect the line was about to receive a vessel of greater value than the nominal amount of cash paid. The court, however, did not examine the substance of this argument, saying merely that the value of the prepayments was no longer open to dispute. Each item on the hidden reserve register was separate from the others and thus fell under its own statute bar. The passage of time since the register was drawn up meant that only those items still open could now be attacked in court. The tax office had based its case on an "order value" which in the event proved to be a non-existent asset. Since this was the only item still in dispute, the tax office no longer had a case.

Supreme Tax Court judgment IV R 47/09 of November 29, 2012, published on January 23, 2013

Informal closedown of employee relief fund revokes tax exemption of previous years

A company decided to close its employee relief fund and instructed the fund management to transfer substantially the entire fund assets to a company that also undertook to meet the related employee pension obligations. The fund regarded itself as having ceased its tax exempt activity on the day of the transfer. However, its governing board made no attempt to pass a resolution to that effect. The Supreme Tax court has now interpreted the asset transfer as an indication that the use of fund assets solely for fund purposes had not been "permanently assured" in previous years. That this condition of tax exemption had been met must be apparent both from the fund's charter and from its actual activity. Transferring assets to another body did not assure the exclusive use of those assets for fund purposes. Accordingly, the fund was to lose its tax exemption for all years in respect of which taxes could be assessed or re-assessed under the statute of limitations (assuming no form of wrong-doing, the statutory period runs for four years from the end of the year in which the tax return was filed). The fund attempted to argue that its decision to transfer its assets was equivalent to its dissolution or to its withdrawal from its tax exempt purpose. Accordingly, previous years should not be affected. The court, however, replied that a transfer of assets did not affect the legal existence of the fund. An interruption of exempt activities did not mean that the fund had already renounced them for all time. The case must therefore rest with the conclusion that the fund had not lost its legal personality; it had merely lost its tax privileges.

Supreme Tax Court judgment I R 78/11 of November 14, 2012, published on February 27, 2013

Stock option benefit realised on disposal

The managing director of a GmbH was granted options to acquire shares in the parent company, an AG. A month later, he transferred the options to his wholly-owned investment management company for a purely nominal amount of 10 ct. each. At that time the shares were quoted on the stock exchange at €1.84. The option exercise price payable to acquire them was fixed at 65 ct. Rather more than a year later, the company chose to exercise the options at which time the market value of the shares had risen to €5.41. The tax office ignored the transfer to the company – as a related-party transaction not at arm's length – and sought to tax the managing director on the benefit from "his" exercise of the options of the difference between €5.41 and 65 ct.

The Supreme Tax Court has now held that no benefit accrued to the managing director at the time of option exercise. His sale of the options to his investment management company was a genuine transaction to be recognised for taxation. The company was not abusive, as it had not been formed in connection with the grant of the options or in order to hold them. His benefit, therefore accrued, on sale of the options to the company and was based on the then current market rate of the shares. It was therefore the difference between €1.84 and 65 ct., i.e. €1.19 per option. The difference between this option value and the price of 10 ct. actually paid was a hidden capital contribution. Whether either consequence could be drawn in practice depended upon whether the tax assessments for the earlier year were still open to adjustment.

Supreme Tax Court judgment VI R 90/10 of September 18, 2012 published on January 30, 2013

Company car benefit – 1% rule confirmed

The private use of a company car may be valued at 1% per month of the manufacturer's list price of the car when new – the "1% rule". However, it is open to the taxpayer to value the private-use benefit at actual cost to the company allocated between business and private travel on the basis of an accurate and detailed log of all business travel – the "log rule". A general manager with the private use of a luxury car leased by the company after it had been used for three years has challenged the list price of the car when new as the basis for the 1% rule on the grounds that it was irrelevant to his personal circumstances. The Supreme Tax Court has now rejected this challenge.

The court took the view that the 1% rule was an intentional generalisation. As such it could not lead to an accurate result in specific cases. It was therefore, on its own terms, not open to attack on specific aspects. As a generalisation ignoring such basic aspects as actual private mileage and actual running costs of the vehicle, it was constitutionally acceptable, given that each and every taxpayer had the alternative of keeping a proper log as a basis for applying the log rule. Thus, even if the taxpayer's complaint were justified in the present instance, he was not prevented from taxing his benefit on the basis of its actual cost. There was thus no breach of the constitution.

Supreme Tax Court judgment VI R 51/11 of December 13, 2012, published on March 6, 2013

Theft from employer is not employment income

A payroll clerk took advantage of an internal control weakness to consistently overpay his salary by exaggerating the gross amount due. Eventually, the fraud was discovered and the company requested the tax office to refund the income tax deducted from the excess. The tax office refused on the basis of a prohibition in the Income Tax Act intended to ensure that employees claim credit in their income tax returns only for those amounts of tax actually deducted from their remuneration. However, the Supreme Tax Court has now held that the prohibition did not apply in this case, as the amount in question had not been deducted from "remuneration for an employment", but from the proceeds of a theft. Accordingly, the salary withholding tax return could be altered as long as it had not become final and binding under the more general rules of the Tax Management Act. In practice, this usually means that alteration is possible for as long as the payroll records remain open to tax office audit.

The Supreme Tax Court reached this conclusion on the basis of the legal definition of employment income as being all benefits "granted" to an employee for his services in public or private employment. This applied to benefits granted voluntarily as well as those the employer was bound to provide and included overpayments of salary made in error. However, amounts stolen had not been "granted" by the employer, but taken by the employee without authorisation to do so. They were thus not employment income, so the tax deducted from them in order to conceal their true nature was not covered by the prohibition on reducing the amount of salary withholding tax due, once it had been certified to the employee.

Supreme Tax Court judgment VI R 38/11 of November 13, 2012 published on February 13, 2013

Job-ticket benefit taxable on option exercise

The company agreed a job ticket programme for its employees with the local transport network. It paid a small fee for each person in return for which he or she could register with the network for an annual season ticket at a reduced price. Payment by both employer and employee was in monthly instalments. The company and the tax office agreed that the taxable benefit in kind to the employee was the fee paid by the company for his or her right to buy the ticket; the tax office, however, insisted that the benefit was annual, taxable in full in the first month the employees were able to draw a ticket under the programme. The company argued that the benefit was monthly, following the agreed payment schedule. The essential difference between the two positions was that a monthly benefit flow would have allowed an exemption for most employees under a rule ignoring benefits in kind of this nature if they did not total more than €44 in the month of receipt.

The Supreme Tax Court has taken a different position altogether. It agreed with the tax office that the benefit arose from the right to buy a cheap season ticket and was therefore annual. However, it did not accrue to the employee until that person exercised his right to buy the ticket by registering for the programme. If he did not do so, there was no taxable benefit as he had merely foregone a possible advantage. The valuation was to be based on the fee paid by the company – but only for those employees who actually acquired tickets – but this was to be reduced to the difference between the price paid by the employee and the price charged by the network under other bulk buying programmes if lower, as only that lower difference was the fair value of the benefit purchased. The case was then referred back to the lower court for the establishment of the facts necessary for these calculations.

Supreme Tax Court judgment VI R 56/11 of November 14, 2012 published on February 20, 2013

Upper limit for tax-free employee functions confirmed for the moment

Employee outings, staff dinners and similar “jollies” entertain employees and are thus potentially a taxable benefit if the intention is to reward them for past or future services. As against this, it is often argued that there is no taxable benefit, because the intention is not to reward anyone for anything, but to encourage staff to foster their mutual relations with a consequent improvement in the working environment. Obviously, both propositions are subjective, and the Supreme Tax Court has resolved the clash in the past by setting an upper limit to the total cost of a jolly per participant. If the cost exceeds the limit – currently and at the time of the present case €110 per participant – the jolly is to be seen as an employee incentive and the entire amount is taxable. If the limit is observed, the event may be assumed to be in the employer’s interests – provided it is open to all employees without distinction by position, performance or length of service – and the entire cost will be allowable for the employer as a business expense and no benefit shall be deemed to accrue to employees.

A law firm organised a summer celebration for its staff at an actual cost of €175 per head. The outlay arose from room hire, food, drink, live music and transport to and from the location. The law firm claimed nevertheless that the employer interest continued to predominate and pointed out that the official upper limit of €110 was substantially unchanged from the DM 200 set in 1993. It had – in the view of the employer – not kept pace with inflation.

The Supreme Tax Court has now held that the overall upper limit of €110 for each participant can still be regarded as acceptable, but only just. It applies to all direct costs of the event other than those clearly attributable to other employer functions (meetings) in the wake of the main event or those incurred on behalf of individual participants to be taxed (or not) by them as their own benefits. The direct costs of an employee benefit did not, for example, include accounting or event manager costs. Taxi costs for participants returning home were individual and not to be included in the overall total. This total was to be divided by the number of actual participants. It the result was more than the current upper limit, the entire amount was taxable as an employee benefit. Given that other conditions were met, the tax could be paid (and borne) by the employer in a lump sum of 25% of the total, non-individual direct cost of the occasion. The court, however, also made side remarks (*obiter dicta*) suggesting that the tax administration review whether the present upper limit of €110 was still appropriate for the future and also reserving its right to completely reconsider its overall approach to the problem of distinguishing between the reward and the business purpose elements of employee jollies in a future case.

Supreme Tax Court judgment VI R 79/10 of December 12, 2012, published on February 20, 2013

Payment for non-compete clause can be VAT-free as part of the sale of a business

The proceeds from the sale of a self-contained business are not turnover subject to VAT, provided the sale includes all assets necessary for the purchaser to continue the operation. The sellers of a nursing service took this to include the amount received from the buyer in return for their undertaking for the next two years not to operate a competing business within a distance of 100 km and not to entice customers (patients) to seek a rival service. This agreement to refrain from competing with the buyers was included in the contract for the sale of the business. The contract put a value on the restraint, but went on to add that the amount mentioned was not a further payment obligation as it had already been included in the selling price. The tax office, however, took the view that the undertaking not to compete was a separate transaction subject to VAT as a service provided. In this, it pointed to the fact that the undertaking had been valued separately and that the buyer of the business had merged it into its own operation, rather than continuing to run it as a separate entity.

The Supreme Tax Court decided in favour of the taxpayers for VAT exemption. By its very nature, a nursing service was far more dependent on intangibles than on tangible assets, and an agreement to refrain from competing with the buyer could be an important aspect in the continuing operation. That the original name was discarded was of no moment; the buyer had continued the business under its own name. The fact of the agreed refrainment from competition should be respected; it had been agreed in the context of the sale of a business and the exact contractual status should be ignored as to do otherwise would be to open to all others a free choice between tax liability and tax exemption.

Supreme Tax Court judgment XI R 1/11 of August 29, 2012 published on February 13, 2013

Equipment given away to sell supplies not a sample

Goods given away free of charge are subject to VAT on their direct purchase cost, unless they are given away as samples or as low value gifts (currently a maximum of €35 per year per recipient). A supplier of medical supplies gave away blood sugar testing machine sets to diabetics to promote the sale of test strips. Each set comprised a machine, a needle to pierce the vein and a small number of test strips. The diabetic placed a drop of blood on the strip which the machine then analysed. The result was shown on the display. Each strip could be used only once. The purpose of the gift was to encourage diabetics to regularly test their blood sugar and thus to regularly buy test strips. The supplier regarded the gift of the sets as the supply of samples and therefore as free of VAT. The tax office disagreed, seeing it as a free of charge supply, taxable at its purchase cost (purchase price plus direct costs of the purchase).

The Supreme Tax Court has now decided the dispute in favour of the tax office. A tax-free sample was the free-of-charge supply of an article in order to induce the recipient to buy further quantities of the same article. That definition would only be met, if the intention had been to sell further quantities of the sets. However, there was never any intention of selling the machines, but only the test strips, thus only the free of charge supplies of test strips on their own could possibly rank as the VAT-free supply of samples.

Supreme Tax Court judgment XI R 36/10 of December 12, 2012, published on March 6, 2013

From Europe

Financial transactions tax

In 2011, the European Commission proposed a 0.1% financial transactions tax on all types of banking transaction (0.01% on derivatives). Reactions varied from approval to rejection of the proposal as likely to take too long to implement (Hungary) to rejection of the proposal outright (the UK). Those 11 member states that agree with the proposal as it stands have now received ECOFIN approval from the EU finance ministers meeting as the European Council to introduce a financial transactions tax on the lines originally proposed by the Commission on a coordinated basis. The Commission has been tasked with drawing up a document setting out the nature of the tax and the mutual cooperation requirements for the unanimous approval of the participating member states. The participants are Austria, Belgium Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain.

Shortly afterwards, the European Commission responded with a draft Council directive addressed to those member states wishing to participate. Transposition into national law is called for by September 30, 2013 to take effect on January 1, 2014. Currently, Bulgaria, Cyprus, France, Finland, Greece, Hungary, Ireland, Italy, Romania and Poland have planned or implemented their own financial transactions tax. It will be noted that some of these countries with their own tax are not willing to follow the Commission's proposal. To some extent this reflects differences in concept, not least on the means of preventing financial institutions from shifting transactions into a more favourable territory. The Commission and the participating member states see the solution in harmonisation and co-operation, rendering avoidance illusory, whilst others see it in an effective design of the tax, making avoidance more costly than the potential saving.
The Commission proposes taxing each financial transaction processed by any locally resident bank or other financial institution (including a branch of a foreign bank) with at least one party resident in a participating member state. The basis would be the market value of the consideration for the transaction. The rates would be set by each participating state, but should not be less than 0.1% on mainstream transactions, or 0.01% on derivatives. Certain transactions are to be specifically exempt, an example being the issue of new securities. The draft directive calls for measures to prevent evasion and to re-cast artificial transactions to reflect their true economic intent (an anti-abuse clause), but leaves each member state to take its own concrete steps to secure the system.

Maximum foreign tax credit should not be reduced by domestic allowances

German double tax treaties invariably relieve the foreign tax deducted from dividends paid to natural persons by crediting it against the domestic tax due on that income. The credit is therefore the lesser of the amount actually deducted at source and the domestic tax notionally due on the foreign income had it been earned at home. The German method of calculating this domestic comparison is to apportion the notional German tax due on the entire income before foreign tax credit between the total gross receipts to the gross foreign receipts at issue. This calculation effectively also apportions deductions and personal allowances not associated with a particular income source between the two categories of income received. It therefore assumes that personal burdens qualifying for tax relief are financed from income of all sources in their relative proportions. This thus reduces the maximum foreign tax credit in all cases where the notional domestic tax chargeable is lower than the foreign tax actually paid. A German taxpayer faced with this situation has protested that this method of calculating foreign tax relief on dividend income is a hindrance on the free movement of capital.

The ECJ has now agreed with him and has also held that the restriction on the free movement of capital is unjustified. The German government attempted to argue that the financial burden of a taxpayer's personal circumstances should be seen as being financed from his total income of all sources, although the ECJ referred to its case law on taxation in the context of the free movement of workers holding that personal circumstances were primarily a matter for the state of residence. Thus, the calculation of the notional domestic tax due as a limit for the foreign tax credit should be based on the income proportions after deducting the personal allowances and expenses from the domestic income alone. The court also pointed that this method of apportionment did not mean that the German government could ever receive less tax by virtue of the foreign income earned.

It is worth noting that the finding of the court falls short of limiting the foreign tax credit to the notional amount of domestic tax due on the increase in income from the additional foreign source. This is true for all systems of rising rate scales and was pointed out to the ECJ at the hearing. However, the court could not examine the strict application of a marginal calculation, as this had not been requested by the referring court. Rather, that court had stated in its referral that domestic law precluded it from extending the plea made by its own plaintiff. That part of the question thus remains open.
The ECJ reference is C-168/11 *Beker*, judgment of February 28, 2013.

Foreign assignment tax incentive for employers in other member states

A German resident Danish national took employment with a Danish company involving a three year tour of duty in Benin on a Danish development aid project. Had he worked for a German employer in otherwise similar circumstances, his employment income would have been tax free under rules exempting employment income from an assignment of at least three months to a country with which Germany does not have a double tax treaty. This exemption is unilateral and is not dependent on taxation in the country of assignment. The Danish national obtained exemption in Denmark under similar rules and applied for the same exemption in Germany. This application was refused on the grounds that it was conditional on employment with a German employer.

The ECJ has now held that the German insistence on a German employer restricts the freedom of movement of workers. That freedom is relevant to assignments in third countries, provided the employment is sufficiently closely linked to another EU member state. In this case, the link was close enough – employment contract under Danish law, Danish employer, social security charges paid in Denmark, net salary paid to a Danish bank account. The German government accepted the discrimination, but argued that it was justified in the public interests of fiscal supervision and of restricting support to German development aid projects (n.b. development aid is only one of the activities qualifying for exemption). The ECJ accepted neither argument. The fiscal supervision point was based only on the contention that a German tax office could not turn to a Danish employer for information as easily as to a German one. However, that contention ignored the possibility of turning to the employee himself as a German resident. Without giving him the chance to prove his case, one could not deny him the exemption sought. In any case, the German case was weakened by the court's reference to its practice – on the grounds of general difficulty – of not seeking confirmation from either the German development aid agencies (as employers) or from sources in the country of assignment. The court brushed aside the reference to the restriction of support to German development aid projects with the remark that the German government had not attempted to explain why the furtherance of German development aid objectives required a German employer.

The ECJ case reference is C-544/11 *Petersen*, judgment of February 28, 2013.

EU/Swiss agreement – country of income must grant full allowances to non-resident

A self-employed German couple moved their home to Switzerland but continued to earn their entire income in Germany. As cross-border commuters, they regularly worked in Germany by day, returning home to Switzerland in the evening. Under the German/Swiss double tax treaty, their income was taxable in Germany as the country of source. The German tax office, however, denied them the "income splitting" relief generally available to married couples (effectively, each spouse is taxed on one-half of the joint income, thus ensuring the best use of allowances and, particularly, the progressive rate scale) on the grounds that they were not resident. It cited the EU/Swiss agreement on the free movement of citizens which allows each state to grant reliefs to its own residents whilst denying them to non-residents.

The ECJ has now held the German tax office view to be acceptable as a general principle, given that residents and non-residents are not generally in comparable situations. However, their situations become comparable if they earn their entire – or nearly their entire – income in the country in which they are not resident. This is because they cannot take advantage of the personal allowances and reliefs granted in their country of residence if they receive no income there. In such an event, it behoves the country where the income is earned to grant them the full reliefs available to residents, as otherwise they would lose their entire claim altogether. This, though, would be discrimination contrary to the EU/Swiss free movement agreement. The couple in the case at issue were therefore entitled to the income splitting generally only available to resident married couples.

The ECJ case reference is C-428/11 *Ettwein*, judgment of February 28, 3013.

Criminal proceedings for evasion not excluded by previous administrative penalty

A Swedish taxpayer deliberately under-reported income on his tax return. Consistently with this fraud, he also under-reported VAT and social security dues. In due course, the manipulations came to light and the tax authorities reacted with a fine under the Tax Procedures Act in the form of a surcharge of up to 40% on the previous under-assessments. The public prosecutor followed with a charge under the Tax Offences Act which faced the taxpayer with a penalty of up to six years in prison. He attempted to claim that this second charge was contrary to community law in that it was in breach of the principle set forth in the Charter of Fundamental Rights of the European Union that no one may be tried a second time for a criminal offence of which he or she has already been acquitted or convicted in a binding verdict. The authorities replied that the taxpayer's evasion was entirely a matter for Swedish law and that community law was not relevant.

The ECJ has now held that community law is not, as such, directly relevant within a purely national context of unharmonised taxes, in this case income tax and social security charges. VAT, however, was levied on the direct transposition of the VAT Directive and thus fell within the jurisdiction of the ECJ. Since the present case involved VAT as well as other taxes, the ECJ was not barred from giving a ruling on the questions put to it. Turning to the substance of the matter at hand, it held that the principle of no second trial applied to criminal charges only. If, therefore, the administrative penalty (surcharge on the tax due) were to be seen as administrative only, there would be no bar to opening criminal proceedings against the taxpayer for the same offence. Whether the surcharge levied was administrative or criminal was a matter for the national court. The determination would be on one of three separate bases. A penalty was criminal if it was described as such in national law, if the nature of the offence warranted the designation as criminal, or where the nature and severity of the penalty inflicted were appropriate to crimes rather than to infringements.

The ECJ case reference is C-617/10 *Akerberg Fransson*, judgment of February 26, 2013.

Investment consultancy to retail investment fund free of VAT

An investment consultant undertook the regular provision of buy/sell suggestions to an investment management company in Germany in respect of its retail investment trust fund open to members of the public. The consultant did not take any formal responsibility for success of its suggestions, although the investment management company generally followed them, pausing only to check whether the suggested trade was still within the limits set by the law and by its own statutes. The consultant charged a periodic fee based on the value of the fund's assets. The consultant claimed that its services were effectively fund management and should therefore be free of VAT as the fund, itself, qualified as a "special investment fund" under German law. The tax office took the view that consultancy was not management and refused the application.

The ECJ has held that the consultancy services in these circumstances essentially fell within the context of management. At least they were part of the managerial activity and the fee paid for them should be free of VAT in the interests of the neutrality of the system. If the advice had been provided internally – by the fund's own staff – no VAT would have been due. It was also necessary to bear in mind the reason for the exemption – not to burden private investors with pooled resources with VAT that they would not have borne had they continued to manage their assets on their own.

The ECJ case reference is C-275/11 *GfBk*, judgment of March 7, 2013.

Management charges to employer pension funds not free of VAT

A UK car manufacturer operated a contributory pension scheme for its employees. The contributions were defined in terms of present salary level and the benefits were defined in terms of length of service and final salary level. The contributions were paid into a fund governed by trustees but managed by a professional investment manager. The employer also paid an annual contribution to the fund. The employer's contribution was the shortfall, by which the employee contributions in total failed to provide adequate cover for the additional liabilities of the fund accumulated during the year. All investment and other risks associated with the fund were thus ultimately borne by the employer. The management company claimed that its charges were free of VAT as it was managing a special fund within the meaning of the VAT directive. The English tax authorities (HMRC) claimed that this was not so and that the management fee was taxable as a service rendered to a non-exempt organisation.

The ECJ has now decided in favour of the tax office. The fund was open to present and former employees of the company only. The members bore no risk, as the results of the fund's investments – good or bad – fell to the employer through their equal and opposite effect on his contribution. On the other hand, whilst it was up to each member state to define for itself the "special investment fund" entitled to receive VAT-free management services, that definition had to meet the purpose of the exemption. That purpose was to allow members of the public to combine their investments without suffering a VAT disadvantage over their position as individuals taking the advice of a stockbroker. However the staff members joining the employer pension fund were not in a comparable position to members of the public. Accordingly, their fund could not claim any right to VAT exemption on its management charges borne.

The ECJ case reference is C-424/11 *Wheels*, judgment of March 7, 2013.

Input tax on defence costs of managers on criminal charges not deductible

The two joint managing directors of a GmbH in the building trade were accused of having won a contract put out for tender, on the strength of information obtained on rival bids through bribing an employee of the customer. They appointed lawyers to defend both themselves and the company. Ultimately, the charges were dropped against payment of a fine under an arrangement possible under German criminal law to allow a prosecutor to close a case if he feels the evidence to be too weak to ensure a conviction, if acceptable to the accused in the interests of avoiding a lengthy legal struggle. The lawyers then tendered their bills showing VAT. The tax office refused to accept this VAT as deductible input tax on the grounds that a managing director's defence against criminal charges was a personal matter. Thus, the input tax had not been incurred in earning income.

The German Supreme Tax Court was unsure of the position under the Sixth (now the VAT) Directive. The tax had been incurred in the course of defending managing directors against charges levelled against them personally. The nature of the expense was therefore private. On the other hand, the accusations were of bribery in order to obtain a business advantage. Without the business background, the suspicion of bribery could not have arisen and there would have been no call for any sort of defence. The underlying cause of the expense was therefore business.

The ECJ has responded to this question by placing the emphasis on the "direct and immediate link" to the nature of the expense, rather than to its cause. The nature of the cost was lawyers' fees for the defence (negotiations with the staff of the public prosecutor) against charges laid against the two individuals personally. A successful defence would benefit them in the main privately. That the cause of the cost was business was not disputed; this, though, led to a subjective link, rather than to the "direct and immediate" (objective) link to taxable outputs demanded by the ECJ in previous cases. The tax office was therefore right to refusal an input tax deduction.

The ECJ case reference is C-104/12 *Becker*, judgment of February 21, 2013.

Pre-accession relief rule applicable until Commission rules otherwise?

The Finnish Income Tax Act provides for a ten-year loss carry-forward, but subject to forfeiture on transfer of more than 50% of a company's shares. Tax offices are to disapply this forfeiture rule on application by the company claiming "special circumstances", such as rescue attempts to save the business. The tax authorities have issued official guidance to the effect that the forfeiture rule is to prevent the sale of tax losses and that "special circumstances" include share transfers in order to transfer ownership to the employees or – for family businesses – to the next generation. A manufacturing company faced with the forfeiture of its loss carryforward on a change of shareholders has maintained that it, too, should be granted exemption, even though its circumstances, although not abusive, were not "special" as described in the official guidance. The official guidance was too narrow and the Finnish courts should broaden the definition to render the benefit in the exemption unselective and therefore generally acceptable under European law.

The advocate general on the case has now published her opinion. She explicitly states that she is not taking a view on the state aid nature of the disputed measure. If, however, the exemption is state aid, it was enacted before Finland's accession to the EU and has been consistently applied since. It thus ranks, if at all, as pre-accession aid. By contrast to new aid measures, those instituted prior to a country's accession are to continue to be applied by the authorities and courts unless and until the Commission has established the fact – after completion of all due processes – that the rule at issue constitutes unlawful and unauthorised state aid. This means that until then, the national courts shall apply the law as it stands without reference to the ECJ or other European body.

The ECJ case reference is C-6/12 *P*, opinion of February 7, 2013.

Note: this case has a German parallel inasmuch as the European Commission has ordered Germany not to apply a similar provision exempting corporate recovery cases from loss relief forfeiture on change of shareholder. Germany unsuccessfully sued before the ECJ against this order, the suit being rejected as having been filed too late. Independently of this, a number of German companies are suing the Commission (with German government support) for a rescindment of its order. Interestingly, the Commission is arguing that the German exemption is state aid precisely because of its general nature. The inference is that the Commission could have approved isolated instances of the exemption, but not its general application in all corporate recovery attempts. The advocate general on *P* would seem to be at pains to avoid prejudging a German case on a Finnish issue.

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Breaking news

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Corporate Tax Burdens in Europe

PwC and the Centre for European Economic Research (ZEW) in Mannheim have updated their comparative survey of corporate tax burdens in Europe and a few other reference countries (Canada, Japan and the USA) using the Devereux/Griffith methodology to simulate the actual burden borne by a successful industrial company. This comparison is generally seen as being more meaningful than a simple comparison of statutory rates. The survey was performed for the European Commission and can be downloaded from the Commission's web site at: http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/effective_levels_company_taxation_final_en.pdf

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