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PwC Reports

OECD interim report on BEPS

In July 2013, the OECD was charged by the G20 group of countries with the development of a 15 point action plan to curb base erosion and profit shifting (BEPS) by multinational companies through tax avoidance schemes based on aggressive tax planning. It has now presented its first, interim report on the first seven areas of investigation. The report is interim in the sense that some of the items overlap with other parts of the project; these items are open to revision as necessary to avoid a clash with the final recommendations.

The report is a series of recommendations to governments to change their rules in order to achieve the desired object. Its concrete suggestions are not therefore as such legally binding. The seven suggestions now made are:

- Neutralise hybrid arrangements for the creation of expense without corresponding income (and vice versa)
- Prevention of tax treaty abuse (treaty shopping and substance over form considerations)
- Ensure that transfer pricing rules ascribe value to the location where it is created – particularly in respect to intangibles
- Enhancement of transfer pricing documentation including a common template for national reporting (This is intended to serve the interests of both tax administrations and compliant taxpayers.)
- Response to the enforcement challenges of the digital economy
- Creation of a multilateral instrument for the modification of bilateral tax treaties, especially for the rapid implementation of BEPS measures
- Measures against harmful tax practices of governments.

Proposed tax amending bill

The finance ministry has taken advantage of the need to bring the customs duties sections of the Tax Management Act into line with the revised EU provisions to introduce a number of tax amendments unrelated to customs duties. It has now published a draft bill that has not yet received cabinet approval. Some of the proposals are purely editorial, others enact recent ECJ findings against existing German provisions and still others react to perceived shortcomings of the present tax legislation. In summary:

- The Income Tax Act is to be amended to disallow 60% of the losses (including refinancing costs) from loans granted to entities in which the lender holds more than one-quarter of the ownership rights. This mirrors the corresponding provision of the Corporation Tax Act, the 60% disallowance reflecting the fact that 60% of the income (interest) would be tax-free if the loan were held as a business asset. This also applies to losses from assets placed free-of-charge at a related party debtor’s disposal.

- Payments by employers into pension funds to finance changes in company pension schemes from “pay as you go” to an asset-backed fund capital are to be taxable employment income. However, payments to fulfil for the first time the solvability criteria of the insurance rules are exempt as are payments to cover extraordinary losses of the fund.
- The range of tax-free benefits for employees is to be extended to include payments to social consultants to advise employees on personal or social matters. Employer payments to agencies to provide carers for children or infirm relatives are also to be exempt. This also applies to payments for the carers themselves as a short-term measure necessitated by the job. This latter, care exemption is to be limited to a total outlay of €600 p.a.
- The cost of employee outings and functions are basically taxable as a benefit in kind. The total cost of the event is to be divided by the number of participants. This cost per head is taxable in the hands of each employee taking part, the taxable benefit being the total cost falling on the employee and his or her companions. However the benefit is tax-free if the function was open to all employees and the total cost did not exceed €150 for each employee participating. An employer may hold no more than two tax-free employee events each year.
- The maximum foreign tax credit is henceforth to be calculated at the average tax rate applied to the total income after deducting tax-free personal allowances and expense deductions to alleviate hardship. This follows an ECJ ruling (case 168/11 *Beker* judgment of February 28, 2013). The change is to be applied to all open cases. A similar amendment has been made to the Corporation Tax Act; thus a company not paying corporation tax in the given year continues to lose its foreign tax credit.
- The definition of related-party business transactions open to income adjustment under the Foreign Tax Act is to be redrafted to encompass all transactions that would have had tax consequences for either party, had the transaction been conducted between two unrelated domestic taxpayers. This closes a perceived loophole, rather than being a substantive change in current practice.
- The finance ministry is to be given powers to extend the reverse charge on trade sales of specific goods to other goods not listed in the VAT Act if it becomes aware of fraudulent dealing in those goods. The extension requires the approval of the Bundesrat and may not take effect without European Commission approval. European Council (ECOFIN) approval must also be sought and the new reverse charge must cease if ECOFIN approval is not forthcoming within nine months.

Most of the amendments apply as of the 2015 tax year.

Rules on tax evaders coming forward to be tightened

Originally, the law granted tax evaders who came forward of their own volition immunity from prosecution, provided they fully disclosed their misdeeds and paid the tax together with evasion interest of 6% (simple) p.a. These provisions stemmed from the days in which the German authorities had little hope of discovery of evasion on deposits abroad unless the miscreant attempted to repatriate the capital. However, with improved systems of information exchange and of detection, the situation has progressively improved from the point of view of the authorities. Progressive tightening of the disclosure rules has been the result. The federal finance ministry agreed in the spring with the provincial finance ministries to tighten them still further and has now published draft legislation to put this agreement into effect. The salient points are:

- The statutory period for raising an assessment on previously unreported investment income from states without an automatic information exchange agreement with Germany is not to run until the end of the year in which the offence becomes known to the authorities or until 10 years following the year of its perpetration. This means that an evader with funds parked in an uncooperative tax haven must live for up to 20 years in uncertainty following the year of his last offence.
- The level of fraud below which immunity from prosecution is assured by full and complete voluntary disclosure by an evader of his wrongdoing is to be reduced from €50,000 to €25,000. On the other hand, an evader of sums higher than €25,000 will not be prosecuted if he pays an additional penalty within the period set by the authorities for the payment of the tax at issue and the interest thereon. This penalty is 10% of the tax evaded up to €100,000. If the evasion was more, but not more than €1 m, the rate is 15%. If more than €1 m is at stake, the penalty rate is 20%. Evasion interest at 6% p.a. continues to be due.

- If the attempt to avoid a criminal prosecution is unsuccessful (this is not infrequently the case, usually because of shortcomings in the accuracy or completeness of the disclosure), the penalty payment will not be refunded. However, the courts are at liberty to credit it against a fine. Obviously, it will be for the judiciary to interpret this provision when the time comes, although it presumably means that an offender will not be able to buy himself out of a prison sentence.
- The conditions for coming forward are to be further tightened in detail, in particular to exclude unwarranted advantages for the offender from incomplete disclosure or from delaying disclosure until a tax audit has started and he can see the direction of the auditor's investigations.
- Special rules govern disclosure of fraud in connection with monthly or quarterly VAT and wages withholding tax returns.

The proposal is to take effect from January 1, 2015.

Official Pronouncements

Expense deduction from royalty income paid abroad only if expense exclusively benefits licensee

Royalties paid abroad are subject to withholding tax (30% to natural persons and 15% to corporations, unless reduced by treaty). If the royalty is paid to an EEA citizen resident in an EEA country, the withholding tax may be based on the gross royalty net of direct expenses as known to the creditor and supported by adequate documentation available to him. The finance ministry has now issued a decree tightening the rules by providing that the expenses must have been incurred solely in respect of the licence at issue. Expenses incurred on the technology that would enable its sale to other persons, too, are not exclusive to the licence at issue and thus not deductible, even if there is, in fact, no other licensee.

Asset write-downs for impairment of value

Assets are to be written-down with tax effect as necessary to reflect a permanent loss in value. Should the value rise again later, the previous loss should be written back. The Supreme Tax Court has ruled on value impairment in a number of cases over the past few years. The finance ministry has now summarised its position in the light of these cases in a decree replacing its previous pronouncements on the subject.

The value of assets is permanently impaired if the value has fallen at balance sheet date and is not likely to rise again later. If this is a judgmental issue, a write-down is called for if the reasons for it are stronger than those against. If the value rises again after write-down the loss in value should be written-back. The reason for the rise in value is independent of the reason for the earlier fall.

A depreciable fixed asset should be written down if its value is likely to remain below its written down value for at least half of its remaining useful life. The remaining useful life is to follow the regular depreciation taken. Catastrophic losses and technical obsolescence are assumed to be permanent.

Environmental damage is a reason for writing down property, even if the clean-up obligation is not immediate. Thus the write-down to a lower market value is not precluded by a prohibition on a provision for the expected costs for lack of certainty as to amount or timing of the obligation.

Quoted investments and marketable securities should be written down to their stock exchange value at balance sheet date. The fall in value is to be considered as permanent unless there are objective factors suggesting otherwise (such as a deliberate attempt to "rig" the market). However, redeemable securities should only be written down below their redemption price if there is a danger of default. Other reasons for a lower present market value, e.g. because the interest rate has ceased to be attractive to investors, are not permanent.

Foreign investment fund privilege extended

Foreign investment funds that no longer meet enhanced registration requirements for doing business in Germany after December 22, 2008 may still enjoy tax privileges for a temporary period provided they continue to publish their annual results in the prescribed form. This temporary period has now been extended to cover accounting years up to the first year ending after July 22, 2016. The publication requirement covers the information needed by taxpayers to meet their German obligations; notification to the Central Tax office is an acceptable alternative.

Driver as benefit in kind

Some companies allow senior employees the benefit of a chauffeur-driven company car to get to work or for their private use. The value of the taxable benefit in kind from the provision of a chauffeur is to be based, in principle, on the cost of a similar service available locally on the open market. However, the finance ministry has now simplified matters with a decree allowing an employee to value the benefit from the provision of a chauffeur employed by the company at the direct salary costs (wages, benefits, social security charges, subsistence allowances and training costs) in proportion to the time spent by the driver on that assignment. That time includes waiting time whilst at the disposal of the employee, but not time not assigned or time taken to bring the car to the employee pick-up point or to take it back afterwards. The decree also offers a simpler alternative – at 50% of the taxable value of the provision of the car itself, be it on the basis of a mileage log, be it on the 1% rule. This 50% applies in general both to journeys between home and work and to purely private usage. However, it falls to 40% on the private usage if the employee frequently drives himself and to 25% if he almost always does so.

The employer may choose one of the options when deducting the income tax from the employee's salary. It is then open to the employee to take the other option in his tax return, provided he is able to support his calculation with the necessary figures from the employer's records. No particular form is required for the presentation of this information.

Mobile phone sales reverse charge applies to any mobile device with a SIM card slot

Trade sales of mobile phones of at least €5,000 are reverse charged for VAT. In response to difficulties of definition in respect to modern mobile telecommunication devices with multiple features, the finance ministry has decreed that the reverse charge applies to any mobile device capable of being used as a mobile phone on a public network. In principle this means any device with a SIM card, or with a SIM card slot, that can output a message received as an audible signal. Devices that cannot be used as telephones continue to be subject to mainstream VAT.

VAT on sponsoring contributions

It is sometimes difficult to distinguish between a service fee subject to VAT and a tax-free donation in respect of the contributions to charity by a sponsoring business. The finance ministry has now added to the guidance given in its VAT Implementation Decree with the remark that a recipient of a contribution may refer to the support given by the sponsor on posters, catalogues, event announcements or on its homepage without triggering a charge to VAT. This reference may include the name and logo of the sponsor, but should not be given particular prominence or include a link to the sponsor's own homepage. The sponsor may also refer to his sponsorship in his own media. However, there will be a charge to VAT if he does so in exercise of an explicit right to "market" his sponsorship as part of his own advertising.

Supreme Tax Court Cases

DTT France – compensation for loss of employment taxable in state of employment

The Supreme Tax Court has repeatedly held that redundancy or compensation for loss of office payments to employees are employment income to be taxed in the current state of residence. The reasoning is that such payments are made in respect to the future (to persuade the employee to accept the termination of his employment) rather than the past. In particular they are not to be seen as further remuneration for services already rendered. However, the court has now held that this case law – which it continues to uphold – does not apply to the special case of a Germany resident employee of a French company in view of the particular wording of the dependent personal services (employment income) article of the double tax treaty. This article links all remuneration and benefits of any kind "stemming" from an employment to that employment and allocates the taxing right to the state where the work is or was actually performed (subject to special provisions for visitors and cross-border commuters). Thus, the compensation payment of the French subsidiary of a German company to its managing director seconded from the parent "stemmed" from the office exercised in France and was taxable there when paid under a negotiated settlement following the director's resignation from both companies over a dispute on future business policy.

Supreme Tax Court judgment I R 8/13 of July 24, 2013 originally published on December 4, 2013 and republished officially on August 6, 2014.

Accommodation and commuting costs abroad as travelling expenses

An AG seconded an employee to its subsidiary abroad in a non-treaty country. The initial assignment was for three years, although it was later extended to a total of six. The employee was tax resident under local law in the country of assignment and also retained his German apartment and therefore his German tax residence. His employment income was thus taxable in Germany with a credit available for the foreign tax paid. He was accompanied by his wife and children for the duration of the assignment. He claimed double household relief on the costs of his accommodation abroad and mileage allowance on the costs of driving to and from work each day. The tax office refused the double household relief claim because his family had moved abroad with him and allowed him only the employee commuter deduction (one half the amount claimed) for driving to work.

The Supreme Tax Court has held that the assignment was temporary despite its six year duration. Both parties had intended from the start that the employee should return to Germany once the assignment was over. The parent company continued to pay part of his salary and otherwise continued to act as his employer. His place of work therefore continued to be the head office of the parent company from where he had been seconded and to where he ultimately returned. In consequence all accommodation and travelling costs incurred in connection with his assignment to the foreign subsidiary were deductible as business travel costs from his employment income. This included the daily commute. Reimbursements by the employer were tax-free. The only exception made by the court was the cost of the accommodation of his wife and children. These costs were private and not deductible. This meant that the costs of the shared apartment abroad would have to be divided as appropriate in order to estimate the tax deductible portion reflecting that part of the accommodation occupied by the employee himself.

Supreme Tax Court judgment VI R 11/13 of April 10, 2014 published on July 16

No deduction for preparatory costs of failed foreign PE

A medical partnership intended to open a branch in Dubai. To this end one of the partners incurred significant costs in flying to Dubai for consultations with government officials and future business partners. In the event, the formation efforts came to nought and the partnership claimed a deduction in Germany for the costs incurred in vain. The tax office refused on the grounds that the Dubai branch would have been a permanent establishment within the meaning of the double tax treaty with the UAE (United Arab Emirates).

The Supreme Tax Court has now agreed with the tax office. The costs were attributable to the Dubai permanent establishment and were therefore deductible in the UAE under the double tax treaty. That the PE was ultimately never formed did not make the costs deductible in Germany (note: this is not the case with costs incurred in vain on the formation of a PE elsewhere in the EU). The costs were not incurred in connection with a German business activity. Under the treaty, they were attributable to the future Dubai PE and to that entity only.

Supreme Tax Court judgment I R 56/12 of February 26, 2014 published on July 9

No write-off of amount due from equity investment

The Corporation Tax Act exempts gains on the sale of shares held in other companies. Corresponding losses are disallowed. This disallowance is complemented by a provision disallowing the loss from a bad debt owed by a company in which the creditor holds or held more than 25% of the issued share capital. This bad-debt disallowance applies as of 2009.

A company wrote off an irrecoverable loan due from a company in which it held

24.4% of the share capital. The write-off was recorded in 2008, but the tax office refused to accept it as deductible in that year as the company had made no effort to justify it. The company increased its holding in the debtor to 50% in the following year by buying the (effectively worthless) investment of another shareholder for a nominal amount of €1. The debtor declared bankruptcy shortly after that year-end. The tax office accepted that a bad debt could be substantiated in 2009, but refused to allow a deduction because of the explicit prohibition in the statute. The Supreme Tax Court has now confirmed the tax office in its view, both because of the clear wording of the law and because of the clear legislative intent that the disallowance of capital losses should not be circumvented by substituting loan for equity finance. The court accepted that the effect of the actual provision might be wider than necessary to prevent the abuse at issue, but nonetheless held that that the provision was not, for that reason, invalid. It also accepted that the escape clause allowing a deduction if the creditor could show that a third party would have granted the loan, or allowed it to remain outstanding, in otherwise similar circumstances was difficult to apply in practice. However, this, too, did not invalidate the prohibition or render it constitutionally unreasonable.

Supreme Tax Court judgment I R 87/12 of March 12, 2014 published on June 18

Tax-free gains on sale of shares are net of direct costs of sale

The gain on the sale of shares held by a corporation is tax-free. The gain is defined as the excess of the net proceeds over the base cost (usually, the book value). The net proceeds of sale are after deduction of the selling expenses. An amount equivalent to 5% of the tax-free income is also disallowed. The Supreme Tax Court has heard two cases querying the apparent conflict between the two effective disallowances of costs and also querying the classification of costs as direct selling expenses.

Deducting expenses from tax-free income effectively disallows them. If an amount equivalent to 5% of the tax-free income is also disallowed, the disallowance is effectively doubled, so the sellers. The court, however, held that the disallowance is not doubled. Rather, the exemption of the net gain disallows the direct selling costs, whilst the 5% rule covers the indirect costs of sale that are not specifically identifiable. This rule is general and therefore may not accurately reflect the circumstances in a given case. However, this does not invalidate it as long as its application continues to be reasonable overall.

In the first case, the court held that legal and professional costs incurred in the sale of a subsidiary were direct costs of sale reducing the tax-free gain. However, a bonus paid to a managing director on the occasion of the sale as a reward for long service to the group was not necessarily so. It could be a delayed reward for past service, or it could be, in this case and given a close family relationship, a hidden distribution of profits. That question of fact was referred back to the lower court.

The second case was brought by a company that had speculated in shares on the stock market as a sideline. It hedged its risks with forward contracts in share certificates, but miscalculated its hedges. In the event, its hedging costs exceeded its gains. The tax office saw the two sets of transactions as interlinked and disallowed the net loss. The company saw them as separate and claimed exemption for the gains and a tax deduction for the costs. The court sided with the tax office on the grounds that though the costs arose from legally separate transactions, they would not have been incurred without the speculations. Their only purpose was to contain the risk and therefore the two were economically inseparable.

Supreme Tax Court cases I R 45/13 of March 12, 2014 (costs of sale and golden handshake) and I R 52/12 of April 9, 2014 (hedging costs), both published on June 18

Subsequent sales price adjustments affect tax-free income in year of sale

A company sold its wholly-owned subsidiary under a complex arrangement involving future business co-operation with the buyer. It became clear the following year that the arrangements would not work in practice and the two parties agreed to settle their differences with a further payment to the seller. Both the seller and the tax office agreed that the two payments were tax-free income by nature, although the tax office insisted that they be taken to income in the year of receipt, whilst the taxpayer wished to record the second payment as a late adjustment to the income in the year of sale.

The Supreme Tax Court took the view of the seller. It followed a previous case in which it had held that a bad debt resulting from a buyer's default on his payment obligation for an acquisition should be set against the seller's tax-free income in the year of sale. The same should apply to the present case of a subsequently agreed price adjustment.

Supreme Tax Court judgment I R 55/13 of March 12, 2014 published on June 18

Loss offset deferral unconstitutional?

A company's sole purpose was to own and manage an investment project on behalf of an operating company of the provincial government. In its view, its principal, the operating company, was liable to make good all losses from the project. However, its demands were refused and a lengthy legal battle ensued. At one point its position at court appeared hopeless and it wrote off its claim. This led to a large loss in the accounts. It then became clear that whatever the outcome of the dispute, the government would no longer accept the company as a business partner. Faced with the loss of its business, it went into liquidation. In the event, the liquidator was more successful at court than the previous management and ultimately won the case. This led to a liquidation profit corresponding to the loss brought forward. At this point the "minimum taxation" rule took effect with the consequence that basically only 60% of the loss brought forward could be offset against current income. Since only one assessment is raised for the entire liquidation period, the liquidation assessment is necessarily the final assessment in a company's lifetime. The remaining loss carry forward therefore lapsed unused. Given that this consequence is indisputable under the terms of the tax acts, the company based its case on the grounds that the provision, as such, is an unconstitutional offence against the guarantee of unfettered ownership.

The Supreme Tax Court does not go as far as the taxpayer. It accepts the "minimum taxation" provision as being within the constitution in the normal course of events. The primary effect is deferral and it is within the authority of parliament to defer a tax privilege such as loss offset in the interests of secure public finances. It also considers that even the confiscatory effect of taxing part of the profit earned in a final period whilst allowing a remaining loss carry-forward to go unused does not offend against the constitution. The guarantee of unfettered ownership is not a guarantee of business success. However, it sees the present case as something of an exception in that the cause of the loss and the cause of the profit – write-down followed by recovery of a receivable – are inseparable. The profit is the consequence of the loss and to treat it differently to the permanent disadvantage of the taxpayer is to breach the constitutional demand for equal treatment of like circumstances. How the Constitutional Court will decide the matter remains to be seen.

Supreme Tax Court decision I R 59/12 of February 26, 2014 published on September 3

No provision for costs of voluntary audit

A KG was obliged to submit to an annual audit of its financial statements under the terms of its partnership agreement. However, the tax office rejected a provision for the audit cost. The Supreme Tax Court has now agreed with this view. The KG was not under a statutory or contractual obligation to have its accounts audited, so there was no outside third party in a position to force it to do so. Its partnership agreement was an internal matter for its partners. Even if a partner were able to enforce his right to audited accounts, the matter remained internal. At year end, failure to appoint an auditor would have had no consequences for the partnership as a body. The expense arose in the following year when the audit was completed and the benefit felt.

Supreme Tax Court judgment IV R 26/11 of June 5, 2014 published on September 3

Pre-tonnage tax gains fully chargeable to trade tax

A one boat shipping line financed its ship with a foreign currency loan. On commissioning, the line opted for tonnage tax. This option excluded taxation of prior gains and tax recognition of prior losses. As required by the Income Tax Act, the line noted the unrealised exchange gain on the loan from the appreciation of the euro on exercise of the option on a memorandum account. This gain then fell to taxation when either the line was closed, tonnage tax ceased, or the liability was settled.

The line repaid the loan some years later, accepted that the gain should now be charged to corporation tax, but argued for an 80% trade tax exemption. Its basis was the provision in the Trade Tax Act declaring (regularly taxed) income of international shipping to have been 80% earned outside German territorial waters and thus beyond the scope of trade tax.

The Supreme Tax Court has now rejected the company's case. The exchange gain had not been earned through an international shipping operation and did not qualify for the trade tax exemption. The court also rejected a "substance over form" argument to the effect that the gain when realised would have qualified for relief but for the tonnage tax option as irrelevant in the face of a clearly worded statute. Tonnage tax was a simplified taxing formula and certain inequities must inevitably ensue.

Supreme Tax Court judgment IV R 10/11 of June 26, 2014 published on August 13

Write-off of worthless loan to employer as expense of earning income

An employer in financial straits agreed with the workers' council (shop stewards) on a longer working week without immediate reward. Rather, the extra time worked would be recorded for later recognition in a manner still to be determined. Some two years later, the shop stewards agreed to an arrangement whereby the employer would make no cash payment, but would issue a profit-related interest bond (with an interest range of 2%-8%) in redemption of the previously unrewarded time worked. Those accepting the offer found themselves faced with income tax and social security charges on the nominal (taken as being market) value on the securities received. Five years later, the company went into insolvency and the receiver notified employee bondholders that assets were insufficient to meet the claims of the ordinary creditors and that those claims took precedence over those of bondholders. Accordingly, employees must consider their bonds to be worthless.

An employee took this statement as an invitation to claim a write-off of his investment in his tax return as a cost of earning employment income. The tax office refused on the grounds that that bondholder had suffered the loss as an investor and not as an employee. The Supreme Tax Court, however, held that it is necessary to strike a balance between the two concepts based on the actual circumstances. In this case, the employees had worked extra time for the promise of future reward. This had been granted to them in the form of bonds. At no time had there been any question of a cash settlement and it was clear to the court that the employees had accepted the bonds as the only form of payment for work done that they could realistically expect. The loss on the bonds when they became worthless was thus incurred by the holders as employees, rather than as investors. A tax deduction was therefore compelling.

Supreme Tax Court judgment VI R 57/13 of April 10, 2014 published on August 13

Benefit from employee shares to be measured on contract date

The managing director and majority shareholder of an AG that had recently obtained a stock exchange quote sold shares at, it was claimed, a discount to employees, former employees, their close relatives, existing shareholders and selected business partners. The company did not establish a benefit for its employees and therefore made no move to account for payroll taxes. A director maintained that this attitude was correct. His wife had acquired shares from the majority shareholder for market value consideration as a private transaction.

The Supreme Tax Court has now emphasised that shares transferred to an employee or his or her dependants or close relatives lead to a taxable benefit (employment income) for that employee if the consideration for the transfer was less that the market value of the shares and the discount was granted in recognition of services rendered by that employee in that capacity. However, it made the point that the valuation date was not the date of the transfer (the taxable event), but on the date the transfer obligation became binding on both sides. It argued that subsequent movements in the market price were irrelevant to the valuation of an employee benefit, as any advantage they might give to the employee was not granted by the employer for services rendered. This was because both sides had already agreed to a definite transfer price.

The court also held that the mere fact that the employer had passed an asset to the spouse of an employee at a price below its market value did not mean that he had done so in consideration of work done by that employee as an employee. Thus a court could not assume without further ado that the benefit from the transfer was employment income. Further investigation was required.

Supreme Tax Court judgment VI R 73/12 of May 7 2014 published on July 2

60% of liquidation loss deductible by natural person significant investor

Natural persons with a share in a company of at least 1% at any time during the previous five years earn business income on their investment. Under the partial charge system of taxing business investment income, 60% of the dividends received or capital gains realised is charged to income tax as business income. Correspondingly, 60% of related expenditure and capital losses are deductible. A natural person shareholder disputed the application of the latter provision to liquidation losses on the grounds that the liquidation ended the company and thus ended all possibility of future earnings. He held one-third of the share capital in a GmbH and had received a first and final liquidation dividend of 37%. This was his only receipt from the GmbH throughout its existence.

The Supreme Tax Court has accepted the taxpayer's argument in principle, but rejected its application to the present case. A liquidation loss corresponds to a loss on sale of the investment and is therefore normally only deductible by a natural person shareholder with a qualifying holding as to 60%. If, however, there is no prospect of earning income in the future, and none was earned in the past, the loss is not incurred in connection with earning income. Thus, the 60% limitation must be disapplied and the loss becomes fully deductible as a business loss. However, the term "income" is to be seen in cash terms; thus a liquidation dividend is "income" in this context. Hence, the shareholder had received "income" from his investment and thus fell under the partial charge system in respect of costs or losses.

Supreme Tax Court judgment IX R 19/13 of May 6, 2014 published on July 16

Insurance premium rebates not employment income if also available to employees of other companies

An insurance company granted its employees a rebate off premiums on policies concluded with it, or with other insurers in which it held an interest. The details were set out in the staff handbook. A tax office saw these rebates as a benefit to the employees from their employment and therefore taxable as employment income. The insurance company disputed this position on the grounds that the same benefits were available to employees of other companies and had not been granted to its own employees in return for services rendered. One of the subsidiaries involved granted the same rebate to all employees throughout the insurance industry and the other granted them to the staff of named companies outside the group.

The Supreme Tax Court has now sided with the company. If the same benefit was freely available to employees of other companies for no other reason than their employment relationship, then they had not been granted to the company's own employees for services rendered. They were therefore not employment income and the company was not responsible for payroll withholding taxes. That the rebates were described in the staff handbook and the employer allowed staff from the other companies access to facilities as necessary for negotiating and concluding contracts did not automatically mean that the employer had arranged for third-party benefits to the employees as a reward for work done. Rather, the arrangements could be seen as being for the mutual benefit of all the insurers involved – by identifying an easily approachable circle of potential customers, selling costs were kept to a minimum.

Supreme Tax Court judgment VI R 62/11 of April 10, 2014 published on July 16

Pension promise to owner/manager hidden distribution

A 58 year old managing director and majority shareholder of a GmbH was promised a fixed monthly pension to be drawn from age 68 onwards (ten years being the minimum period of service for a related party pension entitlement which the tax authorities are prepared to accept). However, his contract of employment allowed termination by either party at age 65 without notice. In the event, he stood down at age 63, although the pension promise was allowed to continue unaltered. The tax office insisted that the provision should then be released back to income and the pension expense of future years be disallowed.

The Supreme Tax Court has now held that the provision as such must be accepted. The promise was given under a legally binding agreement and the GmbH remained liable for fulfilment. However, the managing director's retirement at 63 meant that at that point at the latest each party had accepted that he would not earn his pension over at least ten years of service. Accordingly, the annual pension charge was to be disallowed as a hidden distribution of profit. To the extent that assessments of earlier years were now final and could no longer be altered, the corresponding pension payments were to be treated as hidden distributions when made.

Supreme Tax Court judgment I R 76/13 of June 25, 2014 published on September 3

No tax deduction on confiscation of gains from corrupt dealing, unless tax effect had not been taken into account

A motor vehicle workshop consultant bribed an inspector of a motorcar factory to recommend his services to dealers and service points planning to reorganise or expand their workshops. In due course the arrangement came to light and the consultant, the inspector and, as an accessory, the wife of the inspector were convicted of corruption. The tax office refused to accept either the bribes, the costs of the criminal proceedings or the surrender of the illegitimate gains as deductible expenses of the consultant.

The Supreme Tax Court has upheld the position of the tax office, despite attempts by the consultant to argue that the "bribes" were, in fact, genuine commissions for business introductions. He, the consultant, was aware of no wrong-doing and had only pleaded guilty at his criminal trial in response to a "threat" by the judge of a longer custodial sentence if he did not do so. The tax court found, however, that the judge had not "threatened" anything, but had merely informed the accused of standard criminal court practice in such cases. As it was, he received a two-year suspended prison sentence with costs and surrender of his ill-gotten gains, two years being the longest period that can be suspended under German criminal law. Had he been truly convinced of his innocence, he could have pleaded not guilty in the hope of an acquittal. The Supreme Tax Court thus took the fact of the bribes as proven. Neither the bribes themselves not the court and other legal costs of the trial, nor the penalties inflicted could therefore be deducted. The only question remaining was the calculation of the amount of the illegitimate gains surrendered. The tax effect could not be taken into account twice to the disadvantage, or advantage, of the taxpayer. If the criminal court had taken the tax paid on the "gains" into account when setting the surrender amount, no further tax benefit could be granted by the tax courts. If the amount had been calculated gross, a tax deduction (reflecting the tax originally paid) could be indicated now. Whilst the actual basis of the calculation was not entirely clear (due to confusion following a misquoted reference) all the indications pointed to a net of tax approach by the criminal court. The tax court could therefore allow no further benefit.

Supreme Tax Court judgment X R 23/12 of May 14, 2014 published on August 13

Sale of mining right as sale of real estate

A farmer transferred his holding to his son, but retained the right to mine the salt deposits underneath the site. He then sold this right to an energy company. The energy company's intention was to flush out the salt and then to use the hollow for the storage of natural gas. The contract for the sale of the mining right described the transfer as a final, irrevocable transaction for a single payment. The seller followed this description and treated the transaction as the sale of a property right, taxable under the rules for capital gains. In this case the gain was exempt as the mining right had been held for more than ten years. The tax office saw the sale of the mining right as a mining royalty paid in advance and thus taxable in full as current income over the expected period of active mining.

The Supreme Tax Court has now held the sale to have been a final transfer of the right. Accordingly, it should be taxed as a sale of property. The proceeds were not a mining royalty paid in advance as there was no provision for the eventual reversion of the right, or the right to use the hollow, to the seller. Rather, that right had been fully transferred to the buyer and it was now for him to arrange with the site-owner (landlord) the necessary access for exploitation.

Supreme Tax Court judgment IX R 25/13 of February 11, 2014 published on June 18

Employee withholding tax – tax office opinion not obviously wrong

Employers are entitled to ask the tax office for information on their employee salary withholding tax obligations. The request must be answered correctly and the answer absolves the employer from further risk of non-compliance if he follows it. If, however, he does not, he is in danger of being held liable for failing to account for the full amount of tax due.

An employer requested a tax office statement on the withholding tax position on employee overtime hours carried forward for later time off or pay out. The tax office replied that, generally, no withholding tax need be deducted until payment was made. However, directors and shareholders with more than 25% were the exception. Employees of this status would not normally expect overtime payments, so any record of time to be carried forward for future settlement must be deemed a taxable benefit to be taxed when credited to the person concerned. This statement was in accordance with a finance ministry decree; however, the employer disputed it and turned to the courts.

The Supreme Tax Court has now held that the employer is entitled to accurate information. However, the purpose of the entitlement is to protect him from the consequences of having failed to properly withhold tax. Its purpose is not to resolve disputed questions of law. Thus, the answer given should address the facts as presented and should reflect the official view of the law, taking the relevant official pronouncements into account. It is for the employee to dispute the interpretation of the law, or the validity of any decrees on the subject, with his own tax office in the context of his own assessment to income tax. The court drew attention to the nature of the withholding tax as a payment on account of the final liability. Overpayments were refunded, thus there was no need for absolute protection against their incidence.

Supreme tax court judgment VI R 23/13 of February 27, 2014 published on June 4

No change from lump sum to mileage log company car benefit during year

Those entitled to use company cars privately calculate the monthly taxable benefit at a fixed rate of 1% of the list price of the car when new. However, the taxpayer has the alternative of taxing the actual cost of the private use of the car as determined on the basis of an accurate mileage log detailing the business journeys. The costs are to be established for the year for apportionment between business and private use as shown by the log. Those using more than one car during a given year may exercise the option separately for each car. However, the Supreme Tax Court has now held that a taxpayer may not change from the 1% method to a mileage log method in respect of the same car during the year. It reasoned that the benefit can only be calculated accurately, if all the costs incurred are taken into account. This includes the fixed costs and these are only complete if they are collated for at least a year. Accordingly, a mileage log applied to the actual costs incurred in May-October could not lead to an accurate split of the cost of the benefit. The court emphasised that the monthly basis of the 1% benefit was not to be taken as a variable monthly calculation. Rather, it reflected the monthly accrual of the annual benefit. There was thus no clash of concept between the two calculations.

Supreme Tax Court judgment VI R 35/12 of March 20, 2014 published on June 25

No increase in the allowance for travelling to work for unusual repairs to car

Broadly, employees may claim relief for the cost of travelling to work as a lump sum calculated on the basis of €0.30/km for the distance from home for each day in which the taxpayer visits his main place of employment. This relief is largely independent of the actual means or cost of travel, the only major exception to the general rule being the provision allowing the disabled to claim relief on their actual costs. A management employee suffered a mental lapse on his way to work and filled the tank of his diesel-engined car with petrol. His repair costs were over €4,000 for which he claimed a deduction for vouchered business expenses.

The Supreme Tax Court concurred with the tax office in refusing the claim regardless of its merits. The statute was clearly worded as a provision for an exclusive deduction. There was therefore no room for any additional relief, no matter how well founded economically. Constitutionally, the provision was acceptable. As a generalisation in the interests of overall simplicity it could not be faulted.

Supreme Tax Court judgment VI R 29/13 of March 20, 2014 published on June 25

Shared workspace can lead to home office deduction

Taxpayers with their own home office may claim a deduction for the running costs of up to €1,250 p.a. provided no other workplace is available to them. A tax auditor claimed this deduction on the basis that he had no fixed office facility in his tax office. The assessing tax office refused on the grounds that he shared three work spaces with seven other tax auditors, thus leading to permanent availability of at least one workspace to any tax auditor in the group who needed one.

The Supreme Tax Court has now granted the tax auditor his deduction as requested. He had access to a place of work, although not always when needed. As an auditor he need office space to plan audits, write audit reports and for general admin. If, however, the space available had already been taken by colleagues, he had no alternative but to work from home. This was sufficient for the court to hold that his employer had not provided permanent access to the office facilities required.

Supreme Tax Court judgment VI R 37/13 of February 26, 2014 published on June 4

No VAT return for German branch without taxable turnover

The VAT Implementation Order requires of a foreign business that it register for VAT and then file regular VAT returns if it maintains a registered German branch. A foreign company in this position did so, only to see its return rejected on the grounds that it was not trading in Germany. In point of fact, the branch effectively operated as a representation office, serving as a market support vehicle for its foreign head office. That head office made the German sales direct.

The Supreme Tax Court has now confirmed the tax office stance to the effect that the branch was not an active trading entity and could not of itself lead to a VAT reporting or return obligation for its head office. This follows from the wording of the VAT Directive, which, in the event of a clash, takes precedence over German law. This wording requires actual turnover in the country concerned as a condition of registration. An intention to sell is insufficient. If the company achieves no turnover, it may have recourse to the VAT recovery system for business undertakings from other EEA member states. In this particular case, that avenue was closed, as the filing deadlines had long since been missed. Here, though, the court gave a very strong hint that the authorities could grant a dispensation on the grounds of equity, given that the taxpayer had relied in good faith on the statute as it stood. He could not be expected to recognise its inconsistency with community law, or to take action accordingly.

Supreme Tax Court judgment V R 50/13 of June 5, 2014 published on August 13

Waiver of VAT exemption on property rentals can be by room

A landlord can waive the VAT exemption on property rentals with the agreement of the tenant and provided the tenant uses the rented facility exclusively on a taxable activity. In consequence, the tax office refused to accept a waiver in respect of office space let to a tenant who used it both for his taxable building management business and for his own asset management. The Supreme Tax Court has now held that if the office space used for the two activities can be clearly divided between them, the exemption on that part of the rental paid for the area used on the taxable activity can be waived without prejudice to the remainder, even if the whole area is let under a single contract. The condition is physical, that the space used on the two activities must be clearly segregated based on the nature and layout of the building. Typically, this implies segregation by room and excludes a further split of individual rooms. The court also added that common areas of the office – corridor, kitchen and washrooms – can be attributed entirely to the taxable usage if only a single room is used (wholly or partially) on the tax-free activities.

Supreme Tax Court judgment V R 27/13 of April 24, 2014 published on July 23

Country agent not free of VAT

A US fund appointed an AG as country distributor in Germany. The main task of the AG was to sell shares in the fund through a network of several thousand independent agents. For this it received a commission of 4% of the sales proceeds. However it had to meet the commission entitlement of the agents (sub-agents) from this 4%. Its main task was the selection and supervision of the agents and to support them with information, promotional materials and advertising. It received all orders, reviewed them for completeness – including signature – and forwarded them to the fund. It informed applicants of refusals. It was permitted but not required to sell fund shares on its own account without the services of an agent. The tax office, and now the Supreme Tax Court saw the distributor as a service provider of administrative services with the consequence that its turnover, the 4% commission should be subject (at the time – now the service may well be seen as having been carried out in the USA) to standard rate VAT (19%).

The main argument of the Supreme Tax Court was that tax-free agency services had to be separable and separated from taxable activities. Most of the distributor's duties involve the support and supervision of independent agents on behalf of the fund. Its own sales were incidental to its main task, but could not be separated therefrom. Accordingly, its entire turnover charged to the fund was taxable.

Supreme Tax Court judgment XI R 13/11 of May 14, 2014 published on July 16

Division of input tax on dual-use buildings

A property-owning partnership constructed a four-storey building on one of its sites. Initially it was intended to let the ground and first floors to shops and other businesses and the upper two floors as flats to private individuals. The letting plan changed during the construction period, and this led to delays in finding tenants. Accordingly, there was a period after construction in which significant portions of the building went unlet. The partnership sought to divide the input tax on both the construction and the operating costs on the basis of planned or actual turnover; the tax office pressed for a division by floor space. The partnership followed the Sixth (now the VAT) Directive in dividing the dual-use costs between the taxable and exempt activities in proportion to the respective turnover; the tax office followed the German VAT Act which permits a division by turnover only if no other division is possible. The ECJ has already held that a member state could depart from the turnover-based division of the VAT Directive if the method chosen "guaranteed a more precise" allocation of the input tax at issue – judgment C-511/10 *BLC Baumarkt* of November 8, 2012. Unfortunately the ECJ chose not to explain what it meant by "more precise" when applied to two alternative calculations, both leading to an exact figure. However, that did not stop the tax office in the present case from maintaining that a division by floor space would be "more precise". The Supreme Tax Court has now turned to the ECJ for further enlightenment.

Supreme Tax Court resolution XI R 31/09 of June 5, 2014 published on July 9

Hotel meals in a package are ancillary to the accommodation

A travel organiser arranged full and half-board accommodation packages with hotels abroad which it sold to a local bus (coach) company. It argued that the meals offered with the package (breakfast and evening meal and, in some cases, lunch) were ancillary to the main hotel service of providing accommodation and were therefore taxable as part of that main service, i.e. in the country in which the hotel was located. The tax office countered that the meals were a separate service, taxable in this case in Germany as having been sold to a German business.

The Supreme Tax Court has followed its own previous case law (and also an ECJ case) and held the meals at issue to be ancillary to the main service of providing accommodation. The entire amount charged to the bus company was thus taxable abroad. For the court an ancillary service was subordinate to the main service in the sense that it enabled the customer to obtain the optimal benefit from that main service. For this, it was not necessary that it should be impossible to enjoy an ancillary service on its own (the tax office' argument), but rather that the ancillary service should be seen as secondary by the average consumer. This was the case here with hotel accommodation packages. The customer paid a single amount, restaurant services were typically provided by hoteliers and the amount – about 12.5% of the full/half-board package – was not sufficient to make the subsistence appear as a separate service in its own right.

Supreme Tax Court judgment V R 25/11 of March 3, 2014 published on June 11

Note: this case may have wider implications than might at first sight appear. The arguments concerning the ancillary nature of the meals presented in a dispute on the place of taxation would also seem to apply to questions on the rate of tax to be charged on domestic travel. In Germany restaurant services are taxed at the 19% standard rate whilst only the reduced rate (7%) is due on hotel accommodation. The tax authorities are insistent that businesses separate the two – the hotels when paying VAT and other businesses when deducting the input tax on the business travel of their employees – when the meals are not charged separately (bed and breakfast being a not unusual package). Whether they will change their attitude in the light of this case remains to be seen.

Travel agent's discount does not reduce his taxable commission receipts

A travel agent acted for tour operators for a commission on each tour sold. These commissions were his VAT outputs (taxable turnover). As an inducement to customers he offered them a discount off the price to be paid for their purchases. These discounts were at his own expense and were not rechargeable to the tour operators. He claimed that these discounts should reduce his taxable turnover following the then case law of the Supreme Tax Court. The tax office accepted this claim only insofar as the tours sold were themselves taxable – travel services outside the EU being exempt. The Supreme Tax Court referred the question to the ECJ.

The ECJ held that the discount granted by the agent did not reduce that agent's own turnover, regardless of the VAT status of the underlying transaction. The agent's own turnover was his commission charged to the tour operators. The discounts here at issue did not reduce that charge and had no effect on the tour operators' own costs. The tour operators' own income was also not affected as the agent accounted to them for the full catalogue price of the trip. The discount given was the agent's own expense and had no effect on his taxable turnover. The Supreme Tax Court has now followed this judgment and, in doing so, rendered its own previous case law to the contrary obsolete.

Supreme Tax Court judgment V R 18/11 of February 27, 2014, published on June 11, following the ECJ *Ibero Tours* judgment of January 16 (C-300/12)

Inputs for dual-use buildings generally in output ratio

Living accommodation let to private individuals is VAT-free. Space let to business tenants is taxable turnover if the landlord has exercised the relevant option. The tax on inputs associated with taxable outputs is deductible as input tax; that on those connected with the exempt turnover is not. The VAT directive generally sees the desired split of the dual-use inputs for dual-use buildings to be in the ratio of taxable to exempt outputs. The German VAT Act allows this split only if no other split is economically justified. This latter provision has been generally held by the courts to imply that any other split taken must lead to a "more precise" result. Unfortunately, the courts have, up to now, refrained from defining "more precise".

A taxpayer let the ground floor of her building to retail shops and the first floor to natural person tenants. She charged VAT on the shop rentals, but not on the amounts billed to the private tenants. The tax office pressed for a split based on floor space as being more precise, whilst the taxpayer continued to request a for her preferable split based on turnover. The Supreme Tax Court has now held that a turnover-based split is, in principle, to be favoured as being the primary focus of community law. It then added that the substantially different appointments of the floor let for business use from that let for private accommodation meant that a split based on floor space was not, as such, more precise. Whether that split could, though, be more precise for other reasons was a matter requiring further review by the lower court.

Supreme Tax Court judgment V R 1/10 of May 7, 2014 published on June 11

Airline snacks subject to VAT

An airline supplied its passengers on internal flights within the EU with snacks and drinks free of charge. Further snacks, sweets and drinks were available, but had to be paid for separately. The airline argued that both types of supply were ancillary to the flight as the main supply and the sale should therefore enjoy the same exemption. The airline also argued that supplies should be exempt by analogy under the provision exempting meals and drinks to passengers on ships sailing to or from a foreign port. The tax office accepted that the free of charge items were ancillary to the main supply, but argued that the additional sales on board were subject to VAT.

The Supreme Tax Court has now agreed with the tax office. The additional sales on board were not essential for the enjoyment of the flight, and were thus not ancillary thereto. Rather, they fell under a specific provision calling for their taxation. This provision followed the VAT Directive. The court, however, explicitly reserved judgment on airline meals – paid or not – on longer flights. It also refused the analogy to supplies on board ships. That exemption in the VAT Act had no basis in the VAT Directive and any extension would merely be to extend a community law infringement.

Supreme Tax Court judgment V R 14/13 of February 27, 2014 published on June 4

Energy tax rebate for aircraft not dependent upon official registration as airline

A subsidiary company owned an aircraft which it used to ferry personnel and to deliver urgent packages for other group companies. It also used the aircraft for flight instruction on behalf of third parties. It flew as required and charged a set fee per hour based on flying time. It did not hold a licence to operate as an airline and was therefore unable to fly commercially for anyone except related parties. It applied for refund under the Energy Tax Act of the excise duty on the fuel consumed on its commercial flights. Customs refused as the company was not registered as an airline and could not fly commercially.

The Supreme Tax Court has now held that the company is entitled to a refund in respect of all flights involving the ferrying of goods or passengers charged at going commercial rates as provided by both the Energy Tax Act and the EU Excise Duties Directive. Neither instrument made the refund conditional upon the status of the applicant as an airline. On the other hand, flight instruction flights, test flights and flights to a maintenance centre did not qualify, as they were not directly concerned with the fare-paying transport of personnel or goods. Thus the flights for associated companies qualified for refund, provided only that they were carried out for consideration. This applied regardless of the association.

Supreme Tax Court judgment VII R 29/12 of May 20, 2014 published on August 6

From Europe

Tax groups not broken by foreign parent or intermediate holding

Dutch tax law allows group companies to consolidate their results on the parent with elimination of inter-company gains and losses. However all members of the group must be local entities linked with a 95% shareholding. Sub-subsidiaries may join a group, but only if their immediate parents are also group members. Sub-subsidiaries held by a foreign parent are thus excluded by definition, as are associated companies held by the same parent in another member state. The ECJ has now handed down a joint judgment on three cases before it involving Dutch/German cross-border investment.

In two of the cases the Dutch parent held operating subsidiaries in Holland and Germany. Some of the German subsidiaries held their own subsidiaries in Holland. These sub-subsidiaries applied to join the tax group of their ultimate parent, but were refused because their immediate parents were not, and could not be, group members. Since they were in a comparable position to Dutch sub-subsidiaries of purely national groups, the court held that their exclusion was a breach of their freedom of establishment. Attempts by the government to justify the restriction by the necessity to prevent abuse – a loss double-dip by deducting the loss of a sub-subsidiary once through the group consolidation and a second time through a write-down of the investment in its foreign parent – came to nought, once it became clear that Dutch law in any case excluded gains and losses on the sale of 95% investments from the tax computations.

In the third case, involving two Dutch subsidiaries of the same German parent, the court came to the same conclusion that the refusal to allow them to form their own Dutch group was a restriction on their freedom of establishment in an otherwise comparable situation. The government attempt at justification with the need to protect the tax system from abuse was unsubstantiated and ignored.

The ECJ case references are (sub-subsidiaries of German subsidiaries) C-39/13 *SCA* and C-41/13 *MSA* and (German parent) C-40/13 *X*, joint judgment of June 12, 2014.

Duty on smuggled goods due from any holder

A criminal was convicted of taking unlawful possession of cigarettes smuggled into Germany from Poland. The Customs office responsible for collecting the excise duty sought to make him (and his own "customers") liable for the amount. Their demand was based on a passage in the Tobacco Duty Act making any subsequent holder of dutiable goods liable for any duty previously evaded. The criminal responded with a contention that the Excise Duties Directive made only the actual evader liable for the duty if the evasion was of his making.

The ECJ has responded with a judgment to the effect that neither the directive in question, nor community law in general, preclude a national provision making any subsequent holder of dutiable goods liable for duty evaded on import. The directive does not explicitly address the point, although implicitly it does through the provision making any holder of goods intended for consumption in another member state liable for duty in that state as well as in the state in which they were – legally or not – released into free circulation. This provision must be interpreted as meaning that any holder of unfranked goods in any member state is liable for the duty thereon, regardless of how he acquired them.

The ECJ case reference is C-165/13 *Gross* judgment of July 3, 2014.

Notarial fees may not be charged for the state on change in legal form

On June 28, 2007 the ECJ held that notarial fees payable to register a capital increase were a tax if the notary was required to surrender to the state budget all or part of the fees received. Compulsory notarial fees were therefore in breach of the prohibition in the Capital Duty Directive on taxes other the capital duty defined therein, if the notary was employed as a civil servant and required to surrender 15% of his or her fee receipts to defray state expenditure (C-466/03 *Reiß Beteiligungsgesellschaft*). The province of Baden-Württemberg, where the notaries are civil servants, reacted in December 2011 to this judgment with a waiver of the surrender requirement with retrospective effect to June 1, 2002. However, it did not waive the surrender on fees for registering changes in legal form before January 1, 2009, because, in its view, the Capital Duty Directive expressly excluded changes in legal form from its scope. A notary is contesting the continued fee surrender requirement.

The ECJ has now held in the notary's favour. The Capital Duty Directive does not expressly exclude changes in legal form from its scope altogether; it merely prohibits a charge for capital duty on changes in legal form (from one type of corporation to another) without any increase in share capital. However, it does prohibit additional charges on a company's capital, whether at the time of the increase, or later. A charge for a change in legal form without a capital increase is therefore an effective burden on the existing capital and thus, by implication, prohibited by the directive if the revenue from the charge falls wholly or partially to the state.

The ECJ case reference is C-524/13 *Braun* judgment of July 3, 2014.

Leasing revenue of bank in VAT fraction to include interest portion only

The Portuguese system of splitting the VAT on dual-use inputs by turnover follows the Sixth (now the VAT) Directive. However, the authorities have the right to require a different split, should the turnover-based allocation distort the amount of input tax recoverable. They availed themselves of this right in requiring a bank with a VAT-able leasing business to base its input tax recovery on its dual-use costs not on the total taxable leasing revenue, but, rather, only on that portion of the leasing revenue corresponding to the implicit interest element in the lease payments.

The ECJ has now held that the approach of the tax authorities is permitted under the Sixth Directive as a "more precise" method of establishing the amount of input tax to be recovered, if it is true that the bank's involvement in the selection and purchase of the leased items is minimal. If the bank as lessor is essentially providing a financing service, its revenue from the sale of goods does not involve the use of dual-use inputs and should not therefore increase the VAT recovery on those items. Rather, it should take into account only that portion of the leasing revenue reflecting its actual service as a financing institution, that is, the interest element in the lease fees. The actual scope of the bank's activity in the present case is a matter for the national court.

The ECJ case reference is C-183/13 *Banco Mais* judgment of July 10, 2014.

Higher inheritance tax allowances for residents also for EU taxpayers

The Inheritance and Gift Tax Act grants tax-free allowances based on the degree of kinship on capital transfers to or from a German resident. These allowances range between €20,000 and €500,000. If neither party to the transfer is a German resident, the allowance on a chargeable transfer falls to €2,000 regardless of the degree of kinship. The European Commission sees this distinction as discriminatory and has brought an infringement case against Germany before the ECJ.

The ECJ has now held in favour of the Commission. The distinction restricts the freedom of capital movement of taxpayers resident in other member states of the EU and cannot be justified on the grounds of tax system coherence or control considerations. The higher allowances are given subject only to the domestic residence of at least one of the parties and vary only by degree of kinship. The tax charge on a transfer to or from a domestic resident is therefore solely based on the value of the transfer and on the closeness of the relation between testator/donor and acquirer, neither of which are in any way dependent on the country of residence. Arguments based on control considerations also fail, given that any loss of control from having to consult the authorities of another member state necessarily also arises on cross-border transfers within the EU.

The ECJ explicitly did not rule on transfers falling under a December 2011 amendment to the Inheritance and Gift Tax Act. This allows an acquirer to opt for taxation as though one of the parties had been a German resident, if at least one of them was resident in an EU member state at the time of the transfer. It applies to all assessments still open on December 14, 2011 and to transfers after that date. Initially, the Commission saw this amendment as only a partial solution to the problem; whether it will persist in this stance remains to be seen.

The ECJ case reference is C-211/13 *Commission v. Germany* judgment of September 4, 2011.

Standard fuel tank of vehicle may be fitted other than by manufacturer

A road haulage business required a customised body for one of its lorries. This was ordered separately from a coach builder who fitted it as an adaptation to the original vehicle. In the course of this work, the builder had to dismount and relocate the original fuel tank. He also added a second fuel tank at the request of the owner in order to increase the vehicle's range. The owner could have purchased the vehicle with a second tank already fitted, but did not do so in order to avoid the addition cost of remounting. The business regularly refuelled its vehicles in Holland because diesel oil was cheaper there.

The German customs authority claimed that the fuel had been imported into Germany in non-standard containers and that fuel oil duty was due on the import. The road haulage business contested this claim on the basis of its view of the spirit of the exemption for the import of fuel in the "standard" fuel tanks of motor vehicles. The purpose of this exemption was to avoid double taxation without impeding cross-border road traffic with bureaucracy.

The ECJ has now held that the purpose of the exemption is met in the present case, since the two fuel tanks are permanently fitted to the vehicle and are directly linked to the engine. The fuel is used to power the vehicle. The same would apply to fuel used to drive refrigeration or other systems in operation during transport. Under these circumstances, that fact that the tanks were fitted (or moved) by a person other than the vehicle manufacturer did not invalidate the exemption. There was thus no requirement to pay fuel oil duty for a second time.

The ECJ case reference is C-152/13 *Holger Forstmann* judgment of September 10, 2014.

Reduced VAT rate for books not necessarily applicable to e-books

A Finnish publisher protested against the imposition of VAT at the standard rate on books and periodicals on electronic media such as CD-ROMs or USB sticks (e-books) whilst printed versions of the same publication where only taxed at the reduced rate. His argument essentially was that the intellectual content of the two products was identical and to tax them differently would be in breach of the principles of fiscal neutrality.

The ECJ held that the question was not solely a matter of content, but turned on the perception of the similarity of the products by the average consumer in the member state concerned. This would depend upon local factors including the degree of market penetration of the devices needed to access e-books. It was therefore a matter for the national court to determine. If the average local consumer could be expected to see e-books and printed books as essentially similar products, taxing them at different rates would be in breach of fiscal neutrality.

Note: the German and Finnish VAT acts are similar in this regard, though, obviously, a German court might well come to a different conclusion than its Finnish counterpart on the perceptions of an average consumer.

The ECJ case reference is C-219/13 *K Oy* judgment of September 11, 2014.

Differing forms of double tax relief not restriction on free movement of capital

At the time in question, Germany operated an imputation system of corporation tax. Dividends received from other German companies were taxable income against a credit in the amount of the underlying corporation tax paid by the distributing company on the tax now due by the recipient. If the recipient owed no tax, (e.g. because of losses) his imputation credit was paid out in cash. Dividends from abroad, on the other hand were exempt from corporation tax altogether (minimum shareholding of 10%), the foreign tax then becoming a final burden. A German resident holding company with subsidiaries in other EU member states and in third countries claimed that this distinction placed it at a disadvantage because it was unable to claim any relief for the foreign tax paid, despite its domestic losses.

The ECJ has now held that the company did not suffer any unjustified restriction on its fundamental freedoms. Interestingly, the court held the relevant freedom to be that of capital movement, even though the actual investments ranged from 93% to 100% of the share capital of each subsidiary. The court's basic point here was that the German exemption threshold of a 10% holding was too low to guarantee a significant influence on a subsidiary's management; hence the exemption provision was aimed at capital investment, rather than at the establishment of a business operation.

All foreign subsidiaries fell under the freedom of capital movement. However, the ECJ saw them as being in an objectively different position than domestic investments. Since community law did not require a member state to refund at its own expense a foreign tax paid or to offset a tax disadvantage arising entirely in a foreign state, a member state was entitled to relieve double taxation by exempting the foreign dividend from a further, domestic charge. This preserved the domestic loss carry forward potential and also protected the foreign income from further taxation up to a higher domestic level. It could therefore be of advantage to a taxpayer, not to mention its administrative simplicity.

The ECJ case reference is C-47/12 *Kronos*, judgment of September 11, 2014.

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Editor's Office

Andrew Miles
PricewaterhouseCoopers AG WPG
Friedrich-Ebert-Anlage35-37
60327 Frankfurt am Main

Tel:+49699585-6345
andrew.miles@de.pwc.com

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