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Tax & Legal News

Issue 1
January 20, 2016

pwc

Official Pronouncements

Selling costs of realising partially taxable capital gains to be deducted from taxable portion

In July 2010, the Constitutional Court held that a change in the Income Tax Act reducing the definition of a significant shareholding from over 25% to over 10% was unconstitutional insofar as it led to the taxation of a capital gain that had already accrued tax-free on the date of its promulgation (March 31, 1999). Accordingly, it was necessary to split gains on the sale of shares from holdings of more than 10% but less than 25% into taxable and non-taxable portions, based on the value on March 31, 1999. The finance ministry has now issued two decrees ordering the deduction of the entire costs of the sale from the taxable portion only and refusing any split between the two portions. This applies to gains on selling significant holdings and to those accruing from contributions of shares to a company's operating capital at more than book value (capital contributions in kind as a capital injection or on a merger). However, the decrees are silent on the application of the same principles to a subsequent reduction of the 10% limit to below 1% in 2002 and on the consequences of an excess of selling costs over the taxable portion of the gain. On the other hand, these decrees have no application to private capital gains realised from 2009 onwards which are governed by different principles.

Temporary vehicle insurance cover from agent VAT-free

Motor vehicle insurance agents generally offer temporary third-party cover as a service to enable the vehicle to be registered in the name of the new owner before he or she takes delivery. This cover is traditionally evidenced by an insurance card issued on behalf of the insurer. However, blank cards are often supplied to agents in bulk, with the consequence that the agent is not in immediate and direct contact with the insurer in respect of each and every card issued. The finance ministry has amended its VAT Implementation Decree to emphasise that an agent may also act indirectly (through another company – the card supplier) without loss of VAT-free status. This also applies to the more modern, online system of documenting temporary cover during the vehicle registration process. VAT exemption depends on the agency service as such, that is, establishment of the contact between the insured person and the insurer followed by the conclusion of the contract. It contrasts with the taxable service of the agent for the insurance company, but without a contractual relationship to the insured person (e.g. damage adjustment).

Supreme Tax Court Cases

No deduction for knock-out option losses

A taxpayer invested heavily in "knock-out" options, that is in option contracts for securities or currencies that automatically lapse once the spot price of the subject of the option passes a certain point on the given market. The tax office refused to allow a deduction for his substantial losses from the write off of the premiums paid for now unexercisable and thus worthless options on the grounds that these option lapses were not losses from a taxable activity – investment or speculation. The Supreme Tax Court has now confirmed this view. In reaching this decision, the court drew a distinction between allowable option losses and disallowable lapses. An allowable loss follows from a conscious decision of the taxpayer to exercise or sell the option in order to avoid a further decline in value, or to allow it to expire unexercised by its due date. In the latter event, the loss is the option premium now forfeit. An irrelevant loss from an option lapse, on the other hand does not result from a decision or action by the taxpayer, but solely from market movements over which he has no control. Such losses are not connected with an income earning activity, be it investment or speculation, and cannot therefore be offset against taxable income.

Supreme Tax Court judgment IX R 20/14 of November 10, 2015 published on December 30

Consideration in kind valued on day of contract fulfilment

A shareholder contributed a holding of just over 25% to another company in exchange for new shares to be issued by that company – contribution in kind. The contract set the value of the new shares to be received in consideration at €24. At the time of transfer of the holding, the stock exchange price of the shares of the class to be issued was €18.69. However, this price had fallen to €2.20 by the time the new shares came to be issued, some ten months later. The tax office assessed the seller to a capital gain on the basis of the stock exchange price of the shares to be received on the date of delivery of the shares contributed. Its argument was that the consideration – in the form of the new shares to be issued – was due as of the date of contribution of the shares transferred and that future changes in value of that consideration were, as a subsequent event, a matter for the recipient. The recipient claimed that the gain should be based on the lower value as being the value actually received.

The Supreme Tax Court has now decided the issue in favour of the taxpayer. In this it follows previous rulings reducing a capital gain by the buyer's default, but extends this to value changes to the consideration before delivery and independent of any action by either of the two parties to the transaction. Consideration payable in kind was to be valued on the day of its actual delivery. On the other hand the date of realisation of the capital gain was the date of the transfer of the shares contributed to their new holder.

Supreme Tax Court judgment IX R 43/14 of October 13, 2015 published on January 13, 2016

Tax office answer to a query binding for the assessment unless the converse is apparent

A serving soldier was given leave of absence in order to take up a post as an "international civilian consultant" with the NATO ISAF forces in Afghanistan. He asked the tax office for confirmation that his earnings would not be taxable in Germany, since they were paid by NATO, a supra-national organisation. The tax office replied after "consultation with its superior authority and with the agreement of the provincial finance ministry" that the earnings in question would not be taxable in Germany. This answer was, in point of fact, incorrect and the tax office later demanded a tax return showing the full earnings received. The taxpayer refused, saying he had relied on the accuracy of the information given.

The Supreme Tax Court has now sided with the taxpayer. His query was specific and the answer was definite and given after consultation with other authorities. There was no reason for a tax layman to believe that he could not rely on the information received. That the formalities associated with a binding ruling – in particular the requirements on the request and the fee payment – had not been observed was apparent to the tax office, but not to a taxpayer acting without professional assistance. However, his was the decisive perspective. The fact that he had not relied on the ruling in respect of its subject – he had already agreed to take up the Afghanistan post – was irrelevant to its validity.

Supreme Tax Court judgment I R 45/14 of August 12, 2015 published on December 23

Interest on overpayments in breach of community law to run from date of payment

Overpayments of taxes collected in breach of national law bear simple interest of 0.5% per month for the period between the start of legal proceedings against the tax office for refund and the actual receipt of the refunded amount. However, a company objected to the application of this provision to the interest on a refund of sugar duty originally levied on the basis of an EC regulation later declared invalid by the ECJ. Rather, it maintained that the interest period should run from the date of payment of the disputed amount as more truly reflecting the actual loss to the company from the confiscation of its financial resources. It based this argument on an ECJ case – C-565/11 *Irimie* judgment of April 18, 2013. The Supreme Tax Court has now followed this argument at least in respect of refunds of taxes and dues collected on the basis of an EU regulation later found to be invalid.

Supreme Tax Court judgment VII R 32/14 of September 22, 2015 published on January 13, 2016

Deduction for French social security contributions referred to ECJ

A French tax official lived in Germany with her German civil service husband. Under the terms of the double tax treaty, her salary was excluded from German taxation, but taken into account when establishing the rate to be applied to the rest of the couple's income (principally the husband's pay and allowances). However, the German tax office refused to take the French social security contributions into account – as a deduction because they were directly connected with tax-free income and in the rate calculation because they were a personal relief rather than a cost of earning income. The net result is that the contributions at issue are unrelieved in Germany, whereas full deduction would have been available had the same amounts been paid under a German scheme. The Supreme Tax Court sees potential discrimination and has therefore referred the question to the ECJ.

Supreme Tax Court decision I R 62/13 of September 16, 2015 published on January 13, 2016

From Europe

Foreign branch loss recapture provision confirmed

Up to 1998, a German resident business was allowed to deduct the losses incurred in its foreign permanent establishment, even if the foreign branch profits were excluded by treaty from German taxation. As of 1999, the provision was abolished except for its recapture rule for foreign losses previously deducted. This rule provides for an add-back to taxable income of the previous deduction when that loss is covered by profits in the country of establishment, or where the establishment is sold or wound up.

A German company deducted its Austrian branch losses in 1997 and 1998. From then on, the branch continued to make losses in all years except for 2005 when its assets and business were sold to an Austrian group company. In that year, the German tax office insisted on adding the loss deduction from 1997/98 back to income because the Austrian permanent establishment had ceased trading, whereas the company demanded a further deduction for the losses 1999-2004 because there was no longer any effective deduction in the country in which they had been incurred.

The ECJ has now sided with the tax office on both points. The recapture provision is an essential balance in the coherence of the German tax system, given that the double tax treaty allocates to Austria the sole right to tax Austrian business profits. The original deduction was a privilege to help the German company until it could realise an effective deduction in Austria. Accordingly, its withdrawal was justified once it was no longer felt to be necessary in the political interest. Loss realisation in Austria was ultimately either through actual recovery from realised profits or through effective abandonment by the company through the disposal of its branch business. In either event recapture of the deduction previously claimed was justified.

The ECJ case reference is C-388/14 *Timac Agro* judgment of December 17, 2005.

No automatic charge to import VAT for customs irregularity?

Bonded warehouse operators are liable for the customs duty potentially lost through store-keeping and other administrative irregularities hindering the exercise of proper control by the authorities. In principle, the goods are assumed to have been released into free circulation with the consequent liability to customs and other import duties including VAT. Two German bonded warehouse operators objected to the charge to import VAT on the grounds that there could be no loss of tax revenue by the nature of the offence. The first case concerned a delay of several months in deleting re-exported goods from the inventory records and the second involved the failure to clear re-exported goods through the appropriate customs office at the point of exit from the country. In both cases, the consequence was that at any given moment, the book stock was more than the actual quantity physically present. This led to a customs duty charge on the deficit – assumed release of dutiable goods into free circulation – and to a charge to import VAT, raised because the German import VAT basis follows the customs duty rules.

The advocate general on the two joined cases has suggested that the court side with the taxpayers by holding that import VAT becomes due in circumstances suggesting that the goods might have been released into free circulation at the moment they ceased to be subject to Customs supervision. In the present circumstances this was not the case as the irregularity had not occurred until after, or in connection with, the re-export. Thus, the breach of regulations had not endangered the collection of VAT otherwise due.

The ECJ case references are C-226/14 *Eurogate* (delayed recording) and C-226/14 *DHL Hub Leipzig* (customs clearance failure) joint opinion of January 12, 2016.

No ban on tax consultancy services from abroad without taking qualifications into account

A former German tax consultant (*Steuerberater*) opened a practice in the Netherlands from which he served clients in Germany. A German tax office refused to accept a return prepared with his assistance on the grounds that he was not professionally qualified. He replied that he was lawfully practising from the Netherlands, given that that country did not restrict the provision of tax consultancy services, and that any attempt to stop him from serving German clients was a hindrance on his freedom to provide services throughout the EU.

The ECJ has now held that the German insistence on a professional qualification might be justified in the public interest in competent professional advice. A regulated profession could also help to curb tax evasion. However, any restriction would need to take account of the "proper value" of the qualification actually held in the state of operation. Quite what this means in terms of an unregulated profession in its country of establishment, the court chose not to say.

The ECJ case reference is C-342/14 *X-Steuerberatungsgesellschaft* judgment of December 17, 2015.

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