http://tax-news.pwc.de/german-tax-and-legal-news

Tax & Legal News

Statutes
Cases
Decrees

Issue 3
March 23, 2016

pwc

PwC Reports

Constitutional complaint against trade tax interest add-back rejected

The Trade Tax Act disallows one-quarter of all interest expense over €100,000 p.a. as a deduction from taxable income. Interest in this connection includes the interest element inherent in charges for rented or leased assets. A filling station operator protested that this add-back was unconstitutional in that it breached the principle of taxation according to the ability to pay by disallowing a legitimate business expense. A lower tax court adopted this position as its own and referred the matter to the Constitutional Court for a final decision. The Constitutional Court has, however, refused to try the case because the referring court failed in its duty to explain its complaint in detail. There has always been some form of interest disallowance for trade tax, justified on the basis of trade tax as a charge on business for the benefit of the community for the use made of the local infrastructure, and the various disallowances – effectively increasing taxable income – have been the subject of a number of Constitutional Court and Supreme Tax Court cases in the past. There is also a wealth of literature on the subject. The referring court was duty bound to take existing case law and professional literature into account when coming to its conclusion. Merely citing an abstract principle was wholly insufficient.

Constitutional Court resolution 1 BvL 8/12 of February 15, 2016

Draft regulations on branch profits

The finance ministry has published a discussion draft of its proposed regulations, "administrative principles", on the allocation of business profits between a head office and its foreign permanent establishments. The same principles apply to cross-border profit allocations between two branches of a business from a third country. These regulations follow the "authorised OECD approach" (AOA) now enshrined in the Foreign Tax Act and generally applicable unless a double tax treaty determines otherwise – typically the case with older treaties – and the other country insists on an unchanged treaty application with double taxation of income as a result. The statute is rendered more specific by the Permanent Establishment Profits Allocation Order of October 13, 2014. The present draft expands on the order considerably, dealing in particular with matters on which it is legally impossible to directly apply the "separate entity" concept of the AOA. Examples are the documentation requirements in substitution of the service contract between affiliates or the simulated allocation of branch capital.

Trade and professional associations are invited to comment by May 13, 2016. Businesses or individuals may be able to make their views known through the relevant association.

Official Pronouncements

No general profit realisation as long-term contract payments on account fall due

On May 14, 2014, the Supreme Tax Court held that an engineering office working on long-term construction projects should realise profits as and when the agreed payments on account fell due. This contrasted with the more usual approach of deferring profit realisation until completion of the project as evidenced by the official hand-over. The finance ministry has now issued a decree to the effect that this judgment should only be followed in respect of services governed by the specific regulation in the case decided, i.e. it should only apply to architects and engineers offering planning or design services on long-term construction projects under contractual arrangements agreed before August 17, 2009. Its first application is for business years beginning after December 23, 2014 (date of the official publication of the judgment) and the taxpayer may opt to defer the profit now to be taken up on the advance payments over a two or three-year period.

Redundancy payments decree

Redundancy payments usually qualify as income earned over a period of years. This means that they are taxed at five times the incremental tax on one-fifth of the amount in the year of payment. This "fiving rule" relieves the burden of the progressive rate scale on, particularly, low or medium-range incomes. It is, however, basically conditional on the entire amount being paid in the same tax year. There are a number of exceptions to this condition for social or other reasons and now, under a new finance ministry decree, for low supplementary items. An item is low if it is not more than 10% of the main compensation or if it does not exceed the tax saving from the application of the "fiving rule".

Subsidised meals for staff

The finance ministry has published a decree allowing employers to subsidise one meal daily for their staff at their usual place of work without issuing vouchers. The meal may be taken at a local restaurant or similar establishment. The employer need not conclude a formal agreement with the supplier, although any possibility of employees' converting their subsidy into cash or goods to be taken home must be excluded. The subsidy is subject to the following conditions:

- It may not exceed €6.20 (in 2016) or the price of the meal taken
- Each employee may only receive one subsidy for each day at his or her usual place of work. Thus days off sick or on holiday are excluded as are days spent away from the office on business travel.
- The employer must document entitlement to the subsidy. This can be based on vouchers from the employees or on statements from the restaurant or other institution providing the meals.

The benefit in kind is equivalent to the standardised benefit for staff canteen meals – €3.10 in 2016. This benefit may be taxed by the employer at a flat rate of 25%.

VAT on lease concluded after delivery of asset to customer

The finance ministry has changed its VAT Implementation Decree to the effect that a lease concluded after delivery of the asset to the customer is either a sale and lease-back transaction or the grant of a loan. The distinction depends on the circumstances of the case. A sale and lease-back is to be VAT-ted as a sale by the customer to the leasing company followed by a service by the leasing company to the customer (the monthly rentals). If the sale and lease-back is to be seen as a loan, it will not have VAT consequences.

Market price for VAT on staff sales

Sales to the staff or owners (shareholders or related parties) of a business are subject to VAT on the higher of the amount charged, or the cost to the business. The purpose of this comparison is to prevent attempts at evasion or avoidance of VAT. Accordingly, the courts have held that it should not be applied in cases where there is no danger of VAT irregularity. The government reacted in 2014 with a change to the relevant provision of the VAT Act. The VAT basis for staff/related party sales is now the higher of the price charged and the cost to the business and the latter may not exceed the customary market price. The finance ministry has now followed up with an amendment to its VAT Implementation Decree bringing the examples of VAT on staff sales up to date and discussing its concept of customary market price.

Essentially, the customary market price is the amount the customer would have to pay on the open market for the given item at the same level of trading. Special discounts or rebates to particular groups of customer are to be ignored as are concessions to staff or management. The rule also applies to company cars leased to employees, though not to their private use of cars assigned to them for business purposes.

Supreme Tax Court Cases

Interest limitation – no accumulation of minor loans from significant shareholders

There are a number of exceptions to the interest limitation rule essentially limiting the annual interest deduction to 30% of EBITDA as shown in the accounts. One of these is the equity ratio rule exempting a subsidiary company from the interest limitation if its equity ratio (ratio of shareholder's equity to the balance sheet total) is no more than two percentage points lower than that of the group and no more than 10% of its net interest cost was paid to any one significant shareholder (a shareholder owning more than 25% of the share capital). A loss-making company paying slightly less than 10% of its total net interest cost to each of two significant shareholders claimed exemption from the interest limitation as its equity ratio was better than that of the group. The tax office applied the limitation as the two significant shareholders together received more than 10% of the net interest cost. The finance ministry decree on the application of the interest limitation supports this view.

The Supreme Tax Court has now decided the case in favour of the taxpayer. The interest limitation is an exception to the general principle of taxing the net profit of a company and, as an exception, it must be clearly formulated. Given this demand for clarity, suggestions that applying the 10% limit to all significant shareholders collectively might better reflect the legislative intention have no relevance in the face of the clear wording of the statute – "one shareholder". Similarly, the same wording also excludes suggestions that each significant shareholder is a related party to all others, since the wording clearly treats each shareholder separately.

Supreme Tax Court judgment I R 57/13 of November 11, 2015 published on March 2, 2016.

Golf tournament cost allowed for brewery but disallowed for insurance agency

The Income Tax Act explicitly excludes the costs of hunting, fishing, sailing, cruising and "similar purposes" from a deduction as business entertaining, unless the object of the business is directly linked to the activity concerned (e.g. entertaining customers from the cargo and travel trades on board a ship used for transport). Different senates (chambers) of the Supreme Tax Court have recently come to apparently conflicting decisions on two cases involving the financing of golf tournaments by a brewery (allowed) and by an insurance agency (disallowed). However, the conflict becomes apparent, rather than real, once the underlying circumstances are taken into account.

In both cases, the court found that golf tournaments were a "similar purpose" to hunting, fishing etc. and therefore generally led to disallowable expenses for those bearing their costs. However, the brewery financed the events in fulfilment of a commitment in its contract for the supply of beer and other beverages to the clubs participating in the tournament series. Its tournament costs were therefore effectively a direct deduction from its sales proceeds and allowable under the exception for activities directly linked to the business concerned.

The insurance agency, on the other hand, paid for a golf tournament followed by a dinner-dance for the participants as a fund-raising event for charity. It claimed its outlays as a business expense under the finance ministry decree on sponsoring. The court accepted the sponsoring as such and therefore the classification as business expense, but then drew the conclusion that the business expense was disallowable as being similar to hunting or fishing. The sponsorship decree could not contradict the Income Tax Act; hence any conclusion from that decree must necessarily be void in the face of a contrary provision in the act. Ironically, the insurance agency would have been assured of a deduction for a charitable contribution, had it made a donation of the amount involved to the charity concerned, rather than going through the medium of a golf tournament.

Supreme Tax Court judgments I R 74/13 of October 14, 2015 (brewery) and IV R 24/13 of December 16, 2015 (insurance agency) both published on February 24, 2016

No centre of vital interests in Switzerland for employee working in Liechtenstein

A German resident took up employment in Liechtenstein and rented a two-room flat close by in Switzerland. However, he retained his German home to which he regularly returned to spend the weekend with his family. The lower tax court held him to be resident in Germany rather than in Switzerland and refused him leave to appeal against that decision. The Supreme Tax Court has now confirmed the lower court's refusal.

The Supreme Tax Court saw the issue as a question of interpretation of the facts rather than as a point of law. The lower court's decision was logical and took the full facts into account. That the taxpayer took a different view was not, as such, a ground for appeal. As the Supreme Tax Court went on to state, the taxpayer's family ties were to Germany, where his family remained resident. He had no personal, or lasting economic, ties to Switzerland separate from his Liechtenstein employment. Accordingly, his salary was taxable in Germany, his country of residence.

Note: Germany and Liechtenstein have since concluded a double tax treaty. However, this provides for German taxation of Liechtenstein employment income in the hands of a German resident with a credit for the Liechtenstein tax borne. Thus, the treaty does not affect the validity of the court's ruling as a guide to other, similar cases.

Supreme Tax Court resolution I B 94/14 (NV) of October 22, 2015

Bonus dividend points for co-operative bank members are hidden distributions

A co-operative bank sought to bind its members to its business with a bonus programme based on the award of points for services used. However, the éprogramme was not open to non-members – though they were welcome as customers – and was subject to upper limits on the number of points any one member could earn in a year. Further use of the bank's services once this limit had been reached had no further effect on the member's bonus. For this reason, the bonus programme was different from customer quantity rebates based on total turnover. The exclusion of non-member customers from the programme was a further indication of the intention to benefit the members as investors rather than as customers. Accordingly, the court found that the intent to serve the members as members was stronger than the desire to encourage them as customers. Thus the cost of the bonus programme was a hidden distribution of profit as claimed by the tax office, rather than a deductible sales promotion cost as claimed by the bank.

Supreme Tax Court judgment I R 10/1 of October 28, 2015 published on February 24, 2016

Air passenger duty does not offend against EU law

A foreign airline protested against the air passenger duty levied on the number of passengers flown from German airfields. Essentially, it claimed that the duty was effectively an excise duty on fuel or energy and thus excluded by the Excise Duties Directive. Should that argument fail, it maintained the duty to be illegal due to the unauthorised state aid nature of the exceptions (incoming flights, cargo shipments, feeder flights etc.). It also saw the requirement on foreign airlines to appoint a resident tax representative as a hindrance on the free provision of services and concluded with the assertion, the excise nature of the duty led to a breach of the EU/US open skies agreement.

The Supreme Tax Court has rejected all four arguments. The duty is levied at three different rates for short, medium and long-haul flights. However, it does not differentiate between aircraft types, actual fuel consumption or pollutants emitted. It is therefore not an excise duty within the meaning of the directive. For the same reason, it did not breach the open skies agreement with the US. Whilst the court doubted that the exceptions to the duty constituted state aid, it saw the question as irrelevant to the present case, since the illegal grant of state aid to one party did not give other parties rights to the same aid. It accepted that the need to appoint a domestic tax representative might be a hindrance on the freedom to provide services, but took the position that such a hindrance would not invalidate the tax as assessed; it would merely give the airline a claim for compensation of unnecessary costs. This latter, though, was a different issue. In all four respects the EU-legal position was clear; thus there was no need to turn the ECJ for a ruling on European law.

Supreme Tax Court judgment VII R 55/13 of December 1, 2015 published on March 2, 2016

GmbH & Co. KG can be member of VAT group

An AG operated a ship chartering business through a selection of subsidiaries – one for each ship – formed as GmbH & Co. KGs (limited partnerships with no natural person bearing unlimited liability). It maintained that it should be allowed to deduct the input tax on the costs of raising capital for further investment in shipping and also that it formed a VAT group with its subsidiaries. The tax office disputed both points – as a managing holding company it could not deduct input tax on the costs of further investment and, under the VAT Act, only legal persons could be subsidiaries in a VAT group. The case went to the ECJ which held that a managing holding company could deduct the input tax on the cost of raising capital for a managed subsidiary, the management being its business purpose. The ECJ also held that the restriction in the VAT Act of VAT group members to legal persons had no basis in the VAT Directive and should be disapplied unless it was necessary for the prevention of abuse (ECJ judgment C-108/14 *Larentia + Minerva* of June 16, 2015).

The Supreme Tax Court has now followed the ECJ judgment as it stands in respect to the input tax. It has taken a different line, though, on the question of the VAT group membership. Nothing was apparent to suggest that restricting the membership to legal persons (corporations) might help to prevent abuse – the official justifications for VAT grouping all being based on efficiency and expediency – but it was appropriate to see a GmbH & Co. KG as a legal entity in this context. Accordingly, there was no need to disapply the VAT Act provision defining a VAT group in order to achieve a result in conformity with EU law. Essentially, the argument was that no natural person ultimately bears management responsibility for a GmbH & Co. KG, making the body akin to a corporation. The court also cited other examples of departures from company law definitions when looking at the tax status of legal forms.

Supreme Tax Court judgment XI R 38/12 of January 19, 2016 published on March 9

Factor remains liable for VAT even after surrender of the collection proceeds

A factor accepted the trade debts of a company against an immediate payment of 80% of the nominal amount followed by the remainder when collected from the customers. This 20% was paid over less the agreed factoring interest and other charges. The factor assumed the bad debt risk, although, in the event, was able to collect the factored debts in full. The supplier, though, failed to meet his VAT obligations and then petitioned for bankruptcy. Accordingly, the tax office turned to the factor for the lost VAT under a provision in the VAT Act making a factor jointly liable for the VAT shown on a ceded invoice once the amount has been collected from the customer.

The Supreme Tax Court confirmed the factor’s joint and several liability for the lost VAT. He had accepted the obligation with the cessation (acquisition) of the debts, which, in the event, he had been able to collect in full from the customers. The court brushed aside his protest that he had forwarded the proceeds (less his own charges) to the supplier company which was thus in a position to meet its VAT obligations. Under the relevant provision of the VAT Act, his liability only ceased with the payment of the VAT to the tax office. He could therefore have protected the financial interests of all concerned – including his own – by paying the VAT collected direct to the tax office. He had not done so, and thus had not discharged his liability.

Supreme Tax Court judgment XI R 28/13 of December 16, 2015 published on March 9, 2016

Employee parking charges VAT-able

A law firm located in an area with restricted street parking suffered constant interruptions from employees' having to leave their workplaces in order to move their cars or feed meters. However, client appointments and court appearances made it necessary for them to use their cars to get to the office. The firm therefore leased space in a nearby car park which it sublet to employees at approximately half-price. It claimed the charges – deducted from the employees' net salaries – were VAT-free, as the parking space was provided in the employer's interest of ensuring an undisturbed working environment.

The Supreme Tax Court has held, however, that the employer provided a service to the employees. This service was subject to VAT on the amount charged. That the employer may have seen the service provision as being in his own interests was irrelevant, given the fact of the charge itself. The court went on to add that it would only have been open to the employer to argue the provision of facilities in his own interest – and therefore VAT-free – if the employees had not been charged at all.

Supreme Tax Court judgment V R 63/14 of January 14, 2016 published on March 9

From Europe

Gift tax personal allowances still conflict with EU law?

The Inheritance and Gift Tax Act provides for personal allowances ranging from €500,000 to €20,000 depending on the degree of kinship between testator (donor) and beneficiary. If both parties are non-resident, the personal alliance is only €2,000 regardless of kinship. In 2010, the ECJ held this distinction to be an unacceptable restriction on the free movement of capital (C-510/08 *Mattner* judgment of April 22, 2010) and the government responded by introducing an option for EEA-residents for taxation as German residents for the two periods of ten years before and after the chargeable transfer.

A mother living in England for many years wished to transfer a German property to her two daughters who were similarly long-term British residents. She protested against the low personal allowance for chargeable transfers between residents in another EU country, but refused to exercise the option for taxation as a German resident on the grounds that she could not know what the coming ten years might bring. In support of her position, she claimed that Germany had insufficiently transposed the *Mattner* judgment into national law. This claim brought the case before the ECJ.

The advocate general has now suggested the court rule in favour of the taxpayer. His primary point is that a national law provision in conflict with EU law remains in conflict with EU law, even if there is an option for those affected not to apply it. He also suggests that the court rule that the option, itself, is in conflict with EU law as it cannot be exercised if both donor and beneficiary are resident in third countries (free movement of capital applies worldwide). Lastly, the option is more burdensome on residents of other member states as it requires taxation as a resident for a twenty year period, whereas the corresponding provision for residents merely accumulates all chargeable transfers in the ten years up to the date of the transfer at issue. The government attempted to argue that the two led to the same result, though this would not be true for residents emigrating after the transfer.

The ECJ case reference is C-479/14 *Hünnebeck* opinion of February 18, 2016.

No extension of inheritance tax privilege for repeated transfers to transfers taxable abroad?

The German Inheritance Tax Act includes a provision for partial credit for the tax previously paid on a prior transfer of the same estate during the previous ten years. The credit declines with time and is only available for transfers between spouses or in the direct line. The credit is calculated on the basis of the current transfer, but may not be higher than the proportional amount of the previous charge. Transfers of estates previously taxed abroad are therefore excluded from credit.

A mother living with her daughter in Austria inherited on the latter's decease. The transfer was charged to Austrian inheritance tax (since abolished). The mother then moved to Germany and died shortly afterwards, leaving her estate to her German resident son. The latter claimed the privilege based on the legislative intent of avoiding double taxation and cited the free movement of capital when the tax office refused to grant it.

The ECJ advocate general on the case has suggested the court rule that the free movement of capital is not restricted because the two situations – a previously foreign estate taxed abroad and a home estate taxed at home – are not comparable. Rather, the German legislative intent was to partially relieve a double charge to tax on transfer within the immediate family within a short period of time. However, there was no obligation on Germany to relieve Austrian taxation. Rather, the German relief remained a wholly German matter. However, he goes on to add that, should the court take a different view, the resulting restriction on the freedom of capital movement can be justified on the basis of the coherence of the German tax system, which credits a German tax previously paid by in effect the same taxpayer from a German liability now to be borne.

The ECJ case reference is C-123/15 *Feilen* opinion of March 17, 2016.

From PwC

Breaking news

If you would like to follow the latest news on German tax as it breaks, please visit our Tax& Legal News site at
http://tax-news.pwc.de/german-tax-and-legal-news

English language blogs in which you may be interested are
CITT (Customer and Investor Tax Transparency) News http://blogs.pwc.de/citt/
Establishment of Banks http://blogs.pwc.de/establishment-of-banks/

Editor's Office

Andrew Miles

PricewaterhouseCoopers AG WPG
Friedrich-Ebert-Anlage 35-37
60327 Frankfurt am Main

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

Subscribe

You may take out a new subscription to the newsletter with a simple e-mail to SUBSCRIBE_PwC_Mandanteninformation_E@de.pwc.com. Existing subscriptions may be cancelled at UNSUBSCRIBE_PwC_Mandanteninformation_E@de.pwc.com.