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Official Pronouncements

Crowdfunding: treatment of donations

The Federal Ministry of Finance published a circular on 15 January 2018 on crowdfunding and the conditions for its deduction as a charitable donation. The circular defines various types of crowdfunding and makes a distinction between classic crowdfunding, donation-based crowdfunding and debt-based crowdfunding (also referred to as peer-to peer lending or crowdlending).

Crowdfunding is a form of raising funds from a large number of people (“the crowd”) using the internet. The practice usually involves a project initiator introducing a potential project or product to be developed on an internet portal (known as a crowdfunding platform) in order to raise funds (often a fixed amount). The methods used to raise the funds may be very different in terms of organisation and execution.

Classic crowdfunding: The backers or investors receive some kind of non-financial consideration. This is often a project specimen or prototype created at the end of a project phase (e.g. in the form of some kind of technical asset). As this is a form of advance sale, this type of crowdfunding can also be used as a test of the market potential of a new idea.

Payments made in a classic crowdfunding transaction are not deductible as donations as, inter alia, they lack the gratuitous element. The Ministry of Finance notes that donations are often not deductible because the recipient is not tax privileged (e.g. a charitable organisation) or because the backer receives a consideration for his payment – the question as to whether the payment and the consideration are commensurate is irrelevant here.

Donation-based crowdfunding: This may be understood as the organisation of donations for a particular purpose and with a particular funding target. The crowdfunding platform will only transfer the collected funds to the project initiator once the funding goal has been reached. Neither the donee nor the internet platform receive any consideration. Where the funding goal is not achieved, then in some cases the donees will receive their donations back without any deduction (the principle of "All or Nothing").
The circular sets out the conditions which must be met in order to issue a formal confirmation of a donation and distinguishes between the crowdfunding platform as a tax privileged organisation in its own right and the crowdfunding platform as a trustee.
Where the recipient of the crowdfunding is a tax privileged corporation or a public corporation, it will generally be entitled to issue a formal confirmation of the donation.
Vis-à-vis crowdfunding platforms acting as trustees, the circular also notes that in such cases the option of providing simplified evidence of a donation – this applies to donations of up to € 200, where the payment slip or the booking confirmation will be considered as sufficient evidence – will not be available.

Debt-based lending (Crowdlending): Under this model the backers have a financial interest in the success of the project, so that their investment has an "equity-like" character. In a crowdlending model the backers provide fixed-term loans with fixed interest as an alternative to classic bank financing. Under this model the project initiator is the borrower. Where the investor's assets are merely redistributed in this manner, a deduction as a donation will not be permissible.

Source:
Federal Ministry of Finance circular of 15 December 2017 (IV C 4 – S 2223/17/10001) published on 15 January 2018.

Investment funds: Lending or repo transactions over stock may jeopardise tax benefits

Stock lending – a potential show stopper. The new German Investment Tax Act (GITA) has not yet kicked in and the rules are already becoming more and more complex

Among other topics, the German Ministry of Finance (BMF) has, in a recent circular dated 21st December 2017, clarified that a fund's activities in lending or repo transactions over stock may jeopardise certain tax benefits under the partial tax exemption regime for its German investors. The circular deals with the question whether stocks which are part of stock lending or repo transactions qualify as equity participation and thus form part of the fund's equity participation ratio (EPR).

Depending on the EPR the tax exemption available for the German fund investors varies between 0% and 80%!

More details to be found in our *Asset & Wealth Management Tax & Legal Newsflash* under

https://blogs.pwc.de/german-tax-and-legal-news/files/2018/01/171229_AWM-Newsflash_ENG.pdf

Tax Court Cases

RETT-Blocker: Indirect unification of shares through an intermediary partnership

The Supreme Tax Court has decided that where an intermediary partnership holds direct or indirect interests in a real-estate-owning company, the relevant holding for establishing its interest in the related real-estate holding company, is its interest in the capital of the partnership and not the interest in the jointly owned property according to the law of property.

Thus a share acquisition through an intermediary partnership can lead to a unification of shares within the meaning of the Real Estate Transfer Tax Act ("RETT Act"), if at least 95% of the share in the capital of the partnership is subsequently to be allocated to the purchaser. The question before the Court was whether the share acquisition of the appellant, a British limited company, had led to a unification of shares for Real Estate Transfer Tax ("RETT") purposes.

More details to be found on our *Tax & Legal* site under

https://blogs.pwc.de/german-tax-and-legal-news/2018/01/31/rett-blocker-indirect-unification-of-shares-through-an-intermediary-partnership/

Gift Tax: Benefit provided to person related to a shareholder

The Supreme Tax Court decided in three separate cases that the payment of excessive consideration under the terms of a contract between a GmbH and a party related to the shareholder is not a partial gift by the GmbH, if the shareholder was involved in the conclusion of the contract between the GmbH and the related party. In such a case the benefit granted arises from corporate relationship between the GmbH and the shareholder. With these decisions the Supreme Tax Court has changed its earlier jurisprudence on this question.

Background: In two of the cases (II R 54/15 and II R 32/16) the appellants had each rented out real estate to a company. In each case the appellant was the spouse of the shareholder of the company. The shareholders were either co-signatories of the contracts or had concluded the contract as owner-manager. In the second case (II R 42/16) the appellant sold shares in a company. He was the brother of the shareholder, who had set the purchase price. It was established at the tax audits that the rents paid were too high and the purchase price excessive, thus, for income tax purposes, giving rise in each case to a hidden profit distribution by the GmbHs to their shareholders. In addition the tax authorities took the view that excessive payments constituted partial gifts by the GmbHs to related parties which were subject to gift tax. The Supreme Tax Court did not share this view.

No Gift Tax: excessive payment to a related party arises from the corporate relationship: The Supreme Tax Court held that the payment of an excessive consideration by a GmbH to a party related to the shareholder is not a partial gift by the GmbH to the related party, if the shareholder is involved in the conclusion of the contract between the GmbH and the related party. Such involvement by the shareholder can arise in various situations, for instance where the shareholder concludes the contract between the GmbH and the related party in his capacity as owner-manager, or where he is co-signatory or where he gives the managing director instructions with regard to the conclusion of the contract, or where he works towards or agrees to the conclusion of the contract in any other manner.

Motivation for the excessive payment of rent or purchase price by the GmbH to spouse/brother was the existing corporate relationship between the GmbH and its shareholder. This also applies where a number of shareholders have interests in the GmbH and at least one of them was involved in the agreement between the GmbH and the party related to him. Where the shareholder holds his interest in the GmbH through a parent company, the same principles apply, if he is involved in the conclusion of the contract between the GmbH and the related party.

Comment: These judgments contrast to the Supreme Court's decision on 7 November 2007 (II R 28/06) in which the Court held that such a transaction between the GmbH and a party related to a shareholder could be viewed as a partial gift and the Court now appraised the question differently.

The Court also noted that in such cases the shareholder may himself be the donor. Whether in fact there was a gift between the shareholder and the related party would depend upon the specific features of the relationship, so for example whether there had been an agreement to gift or rather a loan or a purchase agreement. This question was not ruled upon.

Source:
Supreme Tax Court – decisions of the II Senate on 13 September 2017 published on 24 January 2018:
II R 54/15
II R 32/16
II R 42/16

German taxation of dividends paid to Canadian pension fund in conflict with EU law?

The Lower Tax Court of Munich referred preliminary questions to the European Court of Justice regarding the compatibility of the German regime of dividend withholding tax imposed on a Canadian pension fund with the free movement of capital as provided in Article 63 of the Treaty on the Functioning of the European Union.

The plaintiff is a Canadian pension fund in the legal form of a common law trust. The fund received dividends from German stock corporations in the years from 2007 through 2010. The dividends were subject to withholding tax (WHT) of 25%. Pursuant to the Canadian-German double tax treaty, WHT in the amount of 10% of the dividend was repaid to the fund. It thus suffered a final WHT of 15%. The fund applied for a refund of the remaining 15% but the claim was dismissed by the German tax authorities, as German law does not provide for such reimbursement. The Lower Tax Court of Munich considers the Canadian pension fund to be comparable to a pension fund under German law (*Pensionsfonds*). Moreover, the court is of the view that there is a direct link between the dividend income received by a pension fund and its technical reserves which reflect its obligation to pay out the largest part of the income to its insured pensioners. The court does not see any reason why this discrimination could be justified. However, it assumes that Germany's taxation of the plaintiff, which is a resident of a third country, could be compatible with the free movement of capital pursuant to the standstill clause in Article 64 of the Treaty on the Functioning of the European Union (TFEU).

According to Article 64 TFEU the free movement of capital may be restricted if the restrictive national rule already existed on 31 December 1993 and the restriction is related to the provision of financial services.

In this context the Lower Tax Court raises the question whether:

- Article 64 TFEU allows the discrimination in the given case as Germany only changed the taxation regime of its domestic funds after 31 December 1993 whilst foreign funds have always been treated in the same way;
- the restriction involves financial services in the sense of Article 64 TFEU as it is linked to the investments made by the Canadian pension fund rather than to the services it provides to its pensioners.

Source
Lower Tax Court of Munich, decision of October 23, 2017 (7 K 1435/15); the ECJ case reference is C-641/17, *College Pension Plan of British Columbia*

From Europe

ECJ: Social security payments by EU residents in third countries

The European Court of Justice (ECJ) decided that the law requiring a French national resident in a third country to make social security contributions on income arising from assets was justifiable.

More details to be found on our *Tax & Legal* site under

https://blogs.pwc.de/german-tax-and-legal-news/2018/01/29/european-court-of-justice-social-security-payments-by-eu-residents-in-third-countries/

Referral to ECJ: refusal of the deduction of input tax on a payment on account where the supply does not take place

The Supreme Tax Court has referred a number of questions to the European Court of Justice in connection with the deduction of input tax on thermal power units where the supply did not take place and in connection with the adjustment of the deduction of input tax paid on a payment on account. The cases under review concerned supplies of goods which did not take place due to fraud and the related adjustment of the input tax deduction.

Before making final decisions on the cases (V R 29/15 and XI R 44/14 of 21 September 2016) the Supreme Tax Court referred certain questions of EU law to the European Court of Justice (ECJ) for a preliminary ruling. In the opinion of the Supreme Tax Court no input tax deduction could be made on the payment on account for the future supply of a thermal power unit because at the time of the payment the future supply of the thermal power unit was uncertain.

In essence the questions referred were as follows:

1. In cases of fraud by the supplier, how is it to be established whether the supply really was uncertain? In particular, is the taxpayer entitled to a deduction of the input tax paid when the goods were not supplied due to a fraud committed on the side of the supplier?
2. Are there specific provisions in the VAT Directive which support the German provision that the deduction of input tax deductions is dependent on the refund of the payment on account.

The Advocate General has now issued his opinions and made the following recommendations:

Question 1 – uncertainty of supply: Where a taxpayer has made a payment on account for goods or services which were subsequently not delivered or supplied, the input tax deduction on the supply cannot be refused where the taxpayer did not know and could not have known that the supplier did not intend to meet his obligations under the contract. The Advocate General took the view that the fact that the date of delivery was not specified in the contract did not mean that that the fulfilment of the contract was uncertain. In fact the tax authorities may only refuse the input tax deduction if they had sufficient proof that the purchaser knew or must have known that the supplier had no intention of meeting his obligations under the contract from the very beginning.

Question 2 – adjustment of input tax deduction: National provisions according to which the adjustment of input tax is made dependent upon the refund of payments on account do not stand in contradiction to the relevant EU provisions (here Article 184 – 186 of the VAT Directive). The Advocate General considers the condition a legitimate measure: taking into consideration the notion of neutrality within the EU, the measure prevents the taxpayer from actually be able to enjoy an unjustified enrichment in a situation where the input tax remains deducted but payments made are refunded. If on the other hand the payment is not refunded, a taxpayer who is prepared to make a payment upon account does not have to bear any excessive risk where the supplier's intention to deceive is not known and cannot be known.

Source:
Advocate General's opinion of 30 January 2018 (joined proceedings C-660/16, *Kollross* and C-661/16, *Wirtl*).

ECJ – Opinion of Advocate General: losses of non-resident permanent establishment

On 17 January 2018 the Advocate General Campos Sánchez-Bordona published an opinion on a referral to the European Court of Justice by the Eastern Regional Court in Denmark. The case relates to the entitlement of a Danish company to set off the final losses of its Finnish permanent establishment and the compatibility with EU law of Denmark's "international joint taxation" scheme.

Referring to the ECJ's judgment of 13 December 2005 in *Marks & Spencer* (C-446/03), the Advocate General took the view that the Danish legislation according to which a resident company may deduct from the basis of assessment for corporation tax the losses of a national permanent establishment but not those of a permanent establishment situated in another Member State where those losses constituted "final losses", is not compatible with the freedom of establishment (Article 49 TFEU).

More details to be found on our *Tax & Legal* site under

https://blogs.pwc.de/german-tax-and-legal-news/2018/01/19/ecj-opinion-of-advocate-general-losses-of-non-resident-permanent-establishment/

Exemption of loss forfeiture for troubled businesses illicit state aid?

The exception of the German loss restriction rules for acquisitions in the course of a rescue operation to save a troubled business was held by the European General Court as a selective measure as it favours certain companies – those in financial difficulties – over their competitors in the marketplace. Two cases were brought to the ECJ for final clarification. The Advocate General in one of the cases now proposes that the ECJ overturn the judgment of the General Court to the extent that it dismissed the action as unfounded.

In 2009 in a reaction to the economic crisis, the government introduced a temporary exemption (salvage clause) for share acquisitions to enable corporate recovery in Sec. 8c (1a) Corporate Tax Act (CTA) substituting the former regulations in Sec. 8 CTA (old). Its stated objective is to facilitate the preservation of the business in a substantially unchanged form of a company in difficulties. The European Commission saw it as indiscriminate state aid and ordered the German government to disapply it for the future and in retrospect. The government protested, but lost its case before the European Court of Justice (ECJ) on a procedural point following a missed deadline. However, two taxpaying companies sued the Commission in their own names, having suffered the withdrawal of a binding ruling confirming their future entitlement to loss offset despite a "harmful" change of shareholders. In the first instance both companies lost before the General Court which – on February 4, 2016 – confirmed the view of the European Commission. As a result, the cases were brought to the ECJ for final decision.

An Advocate General in one of the cases has now suggested the court overturn the judgment of the General Court of 4 February 2016 in case T-287/11, *Heitkamp BauHolding v Commission*, to the extent that it dismissed the action of the company as unfounded. The Advocate General is convinced that the General Court erred in determining the so called reference system, i. e. the definition of the normal tax system, while answering the question whether Sec. 8c (1a) CTA is a selective (thus prohibited) and illicit state aid.

In order to classify a tax measure as selective, the ordinary or normal tax system applicable in the Member State ("reference system") must be identified. First, the general loss carry-forward for companies under Sec. 8 (1) CTA applies to all companies. It reflects the principle that taxpayers are taxed on the basis of their ability to pay. Second, the rule governing the forfeiture of losses in Sec. 8c (1) CTA, is an exception to that rule because it excludes the acquisition of certain shareholdings (25% or over) from the scope of the general rule. Third, the salvation clause, as set out in Article 8c (1a) CTA, excludes specific scenarios from the scope of the loss forfeiture.

As a matter of fact, the “reference system” applicable here is the unlimited loss utilization and Sec. 8c (1a) CTA – being a part thereof – is not a selective measure. The Commission and the General Court wrongly see a difference between the “salvation clause” in Sec. 8c (1a) CTA and its predecessor, i. e. the “old” salvation clause under Sec. 8 (4) CTA (dealing with the loss restriction for “empty-shell companies”). The difference of both rules are only of formal nature since the “old” salvation clause was part of the overall loss expiry rules and Sec. 8c (1a) CTA was only later incorporated in Sec. 8c CTA as a separate rule. The Advocate General went on to say that the salvation clause simply limits the scope of the rule governing the forfeiture of losses. Therefore, the salvation clause forms an inseparable part of the general rule, namely the loss carry-forward rule.

The ECJ case reference C-203/16 *P Andres (faillite Heitkamp BauHolding) v Commission* opinion of 20 December 2017

From PwC

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The 2017 edition of our popular Guide to Doing Business and Investing in Germany is now off the press and freely available to those interested. It can be downloaded from
http://www.pwc.de/en/internationale-maerkte/doing-business-and-investing-in-germany.html

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