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Tax & Legal News

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Official Pronouncements

Comprehensive car insurance for employees

For 2014, the Income Tax Act provision on employee travelling expenses was reworded to allow tax-free reimbursement of car expenses incurred on business journeys at actual or at the highest rate for government officials as laid down in the Federal Travelling Expenses Act. Currently, this is €0.30/km. The finance ministry has now withdrawn a decree issued under previous law dealing with the tax treatment of the cost to an employer for proving additional insurance cover to an employee using his car on employer business. The consequence is that an employer may now upgrade or supplement an employee's third-party policy to provide comprehensive cover whilst using his car on the employer's business without tax consequences for the individual. Thus, the additional cost to the employer will neither be taxed as a benefit in kind, nor taken into account as a factor reducing the tax-free km allowance.

VAT on asset leasing

The finance ministry has added a passage on equipment leasing to its VAT Implementation Decree to distinguish between the involvement of the leasing company in the transaction before delivery to the user/lessee and its involvement only after that date. If the leasing company (lessor) enters into the transaction before the equipment is delivered to the lessee, it becomes the customer of the supplier on delivery. It then achieves VAT-able turnover from the lease – the lease payments on operating leases or the capital value of the delivery on a financing lease. The distinction between operating and financing leases follows the income tax rules. If the leasing company does not enter into the transaction until after the goods have been delivered to the lessee, it will be seen as acting as a lender of funds. This will generally free it from VAT consequences.

Non-typical silent partnership excludes company from Organschaft

A "typical" silent partnership agreement grants the silent partner a right to share in the profits of a company together with a right to the return of his capital. He may or may not share in the losses, but is excluded from the enterprise management and liquidation surplus. If the agreement allows the silent partner a share in the accretion of intangibles together with at least some degree of managerial influence, the silent partnership arrangement is referred to as "untypical". The finance ministry has now issued a decree excluding a company with an untypical silent partner from membership of a corporation tax group, be it as the parent, be is as a subsidiary. Existing recognised tax groups with an untypical silent partnership holding in the parent will be allowed to continue if the individual circumstances warrant.

Supreme Tax Court Cases

Arm's length related-party loan interest to include risk uplift

The German subsidiary of a Canadian group lent significant sums to its under-capitalised UK subsidiary. The debt proved irrecoverable and was written off in 2002 when the UK company ceased trading. At the time, such write-offs were permitted subject to adherence to the principle of dealing at arm's length. The tax office objected that unsecured loans were not at arm's length.

The Supreme Tax Court has now held that the lack of security does not invalidate the write-off. The lender was entitled to rely on the solidarity of the group, rather than demanding specific security from its subsidiary as debtor. In any case the arm's length income adjustment provision of the Foreign Tax Act applied to trading transactions and relationships, but not to those entered into as a shareholder. The loans in question substituted share capital and their write-off was not subject to income adjustment on the grounds that a third party would not have suffered the loss. However, the interest rate charged should reflect the credit risk actually borne.

In the meantime, there have been several changes to the relevant statutes. In particular, related-party loan losses can only be deducted if a third party creditor would have granted the finance (or allowed it to remain outstanding) under otherwise similar conditions. Also the Foreign Tax Act definition of "trading" has changed somewhat to bring certain aspects of intercompany finance into the scope of arm's length adjustments. However, the general conclusion of the court that an arm's length interest rate must reflect the degree of risk borne by the creditor remains valid and relevant.

Supreme Tax Court judgment I R 29/14 of June 24, 2015 published on September 9

Foreign tax credit rather than exemption does not offend against the constitution

The German/Austrian double tax treaty exempts employee income from taxation in the state of residence if the other state taxes it because the work is performed there for a local employer. However, there is a special provision for aircrew, allowing taxation in the country of residence with a credit for the tax borne in the country of source. Since this led, in the circumstances, to a less favourable result for a German-resident pilot of an Austrian airline, he claimed that the treaty discriminated him as a pilot as opposed to members of other professions. This offended against the constitutional provision calling for equal treatment in like circumstances.

The Supreme Tax Court has now rejected the claim, because the circumstances were not the same for aircrew and other employees. In the view of the court, aircrew have enhanced opportunities for avoiding (or evading) taxation altogether and it was thus legitimate for two states to agree on the foreign tax credit as the instrument of avoiding double taxation, even if this was a departure from the general rule of the treaty calling for taxation of employment income in the country of source only.

Supreme Tax Court judgment I R 47/14 of May 5, 2015 published on August 19

No unilateral treaty override confirmed

A German resident pilot of a US airline, but based in London, claimed that his salary was exempt from German taxation under the aircrew provision of the German/UK tax treaty then in force (taxation in the country of the airline). The tax office accepted the contention without further ado, but then applied the domestic treaty override provision when the pilot failed to show evidence of actual UK taxation.

The Supreme Tax Court has now reaffirmed its previous case law to the effect that the treaty override provision calling for domestic taxation of treaty-exempt income if the other state does not exercise its taxation right (avoidance of "white" income) can only be applied if foreseen by the treaty. At the time, this was not the case (it now is). However, it could not decide the case finally, as there was doubt as to which treaty applied. This was for the lower court to clarify. If the London operation of the US airline ranked as a British airline under English law, the UK treaty would apply and the income in question could only be taxed by the UK authorities. If, however, English law regarded the London operation as part of the US airline, the German/US treaty would apply. Since that treaty foresees taxation of aircrew salaries in the country of residence, the taxation right would fall to Germany regardless of any question of treaty override.

Supreme Tax Court judgment I R 68/14 of May 20, 2015 published on August 19

Commodity warrants are not investments

Xetra-Gold warrants allow holders to speculate on the price of gold. Each represents one gram of gold and their price corresponds to the current gold market price. They have no fixed term, but are dealt with on the stock exchange and are redeemable in kind at any time on the demand of the holder. They are not redeemable in cash. The Supreme Tax Court has now held in two cases that neither the gain on sale on the stock exchange, nor the accretion in value on redemption is taxable as investment income.

The court's main point is that a Xetra-Gold warrant is not a financial investment. It does not have a nominal value or fixed term and is never repayable (redeemable) for cash. A gain on sale on the stock exchange is not therefore a capital gain on the sale of an investment and is also not a gain from a forward contract or from an option exercise (no fixed option price). The gain on value accretion on redemption is potentially taxable as a gain on a privately held commodity, although such gains are only chargeable if the asset was held for no longer than one year.

Supreme Tax Court judgments VIII R 35/14 (sale) and VIII R 4/15 (redemption) of May 12, 2015 published on September 2

No use of electronic data collected by tax auditors against other taxpayers

A tax consultant refused a tax audit request for data on his client billings for fear that it might be used not only to audit his own revenue, but also as a source of information on his clients' affairs. The Supreme Tax Court has held that the tax auditors were entitled to request the data in question, but were not entitled to use it to test the returns of other taxpayers. Thus, they may store the data on their own computers and analyse it in the offices of the entity under audit. They may also take it to their own tax office for evaluation and analyse it there. However, they may not process it in any other location or on any other computer (danger of theft by a third party) and must delete it once it is no longer needed in connection with the affairs of the owner. This is when the assessments for the year in question become binding, that is after resolution of any disputes.

Supreme Tax Court judgment VIII R 52/12 of December 16, 2014 published on August 19, 2015

VAT-free intra-community supply must be supported by required documentation

The VAT Implementation Ordinance details the precise form of documentation that a supplier of goods to a business in another EU member state must maintain for the supplies to be treated as VAT-free. In particular the documents must show the exact destination of the shipment and include appropriate receipts from the carrier. A supplier of goods to an Italian customer failed to provide the tax auditors with adequate documentation of his deliveries – the documents he did supply were variously incomplete, confusing, conflicting and inappropriate – but did offer them written confirmation from the customer that the goods had been subject to acquisition tax in Italy. The tax auditors ignored this offer and subjected the transactions in question to VAT as domestic deliveries.

The Supreme Tax Court has held for the tax office. The documentation furnished (basically incomplete bills of lading and transport manifests) suggested in at least some cases that the deliveries had actually been made to France or even within Germany. The confirmations offered had been signed by people unconnected with the actual transports. Any doubts as to the authenticity of the VAT-free intra-community supplies must be resolved by the taxpayer in the prescribed form. Failure to adhere to the form went to his disadvantage, particularly where the substitute evidence offered was, itself, dubious.

Supreme Tax Court judgment V R 14/14 of March 19, 2015 published on August 19

From Europe

Full expense deduction for tax group members also for foreign subsidiaries

In France, dividends are exempt in the hands of a corporation holding at least 5% of the shares in the payer. However, 5% of the exempt amount is disallowed as a deduction to reflect the business expenses deemed directly attributable. A parent may opt to pool its results with those of some or all of its domestic subsidiaries in which it holds directly or indirectly at least 95%. The effect of this pooling is to tax the income of the subsidiaries only once, although there is no corresponding 5% expense disallowance. Group members are thus privileged over otherwise qualifying subsidiaries remaining outside. Since foreign subsidiaries are excluded *per se* from French tax groups, they are excluded from the privilege. The ECJ has now held that this exclusion is an unwarranted restriction on the parent company's freedom of establishment in other member states.

The ECJ continues to accept the exclusion of foreign subsidiaries from tax groups as such as being necessary to preserve the agreed allocation of taxing rights between member states. However, it does not accept the consequence of an unavoidable expense disallowance on the profits received from subsidiaries otherwise qualifying for tax group membership merely because of their foreign residence. This discrimination is a unilateral measure which cannot be justified on the basis of different circumstances, by the need to protect the cohesion of the tax system or by reference to an offsetting disadvantage.

The consequences of this ruling for other countries remain to be seen. Ultimately they will depend on the degree to which local law regards the situation of group members as comparable to that of non-members. In Germany, members of a tax group must sign a court-registered profit pooling agreement to run for at least five years. This requirement to actually surrender the profits might be seen as placing a group subsidiary in a different position from a subsidiary outside the group. On the other hand the qualifying shareholding for group membership is a simple majority of the voting rights. This is a less stringent requirement than that in force in France.

The ECJ case reference is C-386/14 *Groupe Steria* judgment of September 2, 2015.

No EU objection to German tax rules on EU branch losses?

Up to 1998, German companies were able to deduct foreign branch losses, notwithstanding double tax treaty provisions for taxation of business profits solely in the country of source. However, this deduction was ultimately only temporary inasmuch as it was recaptured on future branch profits, or when the branch was disposed of, wound up or incorporated. A German subsidiary of a French group operated a consistently loss-making Austrian branch from 1997 to 2004. In 2005, the branch made a trading profit before transferring its assets and business to the Austrian subsidiary of the same group. The German tax office refused a deduction for the losses incurred from 1999 onwards and added the 1997/98 deductions back to income in 2005 under the recapture provisions, which remained (and remain) in force. The company objected to both adjustments as a restriction on its freedom of establishment, given that it would have been able to permanently deduct corresponding losses from a German branch.

The ECJ advocate general on the case has suggested the court rule that the refusal to continue to allow a deduction for foreign branch losses from EEA countries after 1998 is not a restriction on the company's freedom of establishment. The company's Austrian losses could be carried forward in Austria and were therefore not permanent. The Austrian branch was not in a comparable position to a German one and thus the loss deduction possibility in Austria as opposed to Germany was not a restriction on the freedom of establishment. Even if it were, it could still be justified by the need to preserve the internationally agreed allocation of taxing rights between treaty partner countries. By contrast, the advocate general agrees with the taxpaying company that the 2005 deduction recapture is a restriction on its freedom of establishment. However, he sees that restriction to be justified by the need to preserve the allocation of taxing rights, the coherence of the German taxation system and by the need to prevent the abuse of offsetting the same loss in both countries. He also points out that the losses were not final in the year they were incurred.

The ECJ case reference is C- 388/14 *Timac Agro* opinion of September 3, 2015.

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