PKF

Accountants & business advisers

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Editorial

Dear Readers,

A Tax CMS is one - for the tax function absolutely crucial - area of an overall CMS. In the second article in our series on the **PKF model for a Tax CMS** we discuss in detail the significance of the **seven fundamental elements** of compliance and tax compliance. Here, the rules of communication assume particular importance, although they are frequently underrated. Reliable communication channels have to be created in a compliance organisation and you can read more on this topic later, in the 'Legal' section, in connection with the subject of whistleblowers.

While cutting taxes is basically a good thing, however, if this happens in accordance with the 'America First' principle then you need to pay close attention. In the first report under 'Tax' you can read about the consequences that arise for German companies from **GILTI** and **FDII**. Following on from that, in the context of profit distributions to corporations, we first discuss the topic of the **instigating relationship** between a shareholding and an interposing GmbH & Co. KG (German limited partnership with a limited liability company as a general partner) in the absence of a DTA. Subsequently, we describe how to avoid the presumption of an abusive tax structure within the meaning of Section 42 of the German Fiscal Code when **merging a profitable company with a loss-making one**. Finally, in the Tax section, we focus on a frequently discussed topic - the **Restructuring Decree**. Here, a constitutional court is indeed going to have to make a ruling on legacy cases.

In the 'Legal' section, we report on a CMS-related issue, namely, the important directive proposed by the EU Commission on the **protection of whistleblowers**. This is followed by a summary of an **ECJ judgement** that could have huge repercussions for working time regulations.

In the Accounting & Finance section, we take a close look at the impact of **digitisation** on **company valuations** and describe how the application of conventional methods should be modified.

We hope that you will find the information in this edition to be interesting.

Your PKF Team

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FOCUS

Tax Compliance Management Systems – Part B: Compliance Analysis (Phase I of the PKF Model)

The current tax compliance status for a company is recorded in Phase I of our tax compliance model (please see the May issue of our newsletter for a complete overview). In the course of this, it is ascertained at a high level whether or not action is required in any of the divisions. On the basis of interviews and check-lists an assessment is then made of how strongly the seven elements of tax compliance have already been developed. The nature, extent and definition of the rules and measures are scrutinised along with the documentation. Here, the scrutinisation as well as the assessment of the Tax CMS are conducted on the basis of standard modules while taking into account the company's individual tax risks.

1. The seven fundamental elements of tax compliance

The structure and workflow of tax compliance systems are based on the seven basic elements shown in fig. 1.

1.1 Tax compliance culture

Culture is generally understood to be a system of rules and practices that guide coexistence and behaviour. Compliance culture is shaped by the basic approach and behaviour patterns of the executive bodies and management; it can be communicated and documented, for example, in a code of conduct, a corporate mission statement or tax guidelines.

In the area of tax it is especially necessary for adherence to tax rules to be deemed to be important and for contraventions to be subject to sanctions within the company

1.2 Tax compliance objectives

Achievable and measurable objectives for the Tax CMS should be defined

Fig. 1: The basic elements of tax compliance

on the basis of general company goals and an analysis and weighting (e.g. in accordance with sector-specific relevance). For example, these could include:

- correct and timely reports on non-deductible business expenses,
- annual reports on tax risks, or
- regular spot checks to ensure compliance with invoicing guidelines.

Such stated objectives can and should be agreed in all the business divisions that are relevant for tax purposes.

1.3 Tax compliance organisation

The organisation is the formal set of rules that are necessary for the functioning of a system that is based on the division of labour. An organisational structure is also vital in order to ensure adherence to tax compliance rules. Competencies, including deputising arrangements, process flows and the assignment of responsibilities are frequently defined on the basis of written check-lists as well as documentation rules.

» **Please note:** A set of rules has to be reviewed regularly with respect to its currentness.

1.4 Tax compliance risks

The risk of rule violations should be identified and assessed on the basis of a system for risk detection and evaluation. In the course of this, the risks can be determined, e.g., for each type of tax. The constituent components of the compliance programme can be derived from these risks.

1.5 Tax compliance programme

The tax compliance programme describes the rules and measures that are supposed to counteract the risks as well as the steps that have to be taken if it is ascertained that rule violations have occurred. This compliance programme should be documented in writing. In this respect, a distinction has to be made between measures for the prevention of rule violations and measures for their detection:

Fig. 2 The Four Phases of the PKF Tax Compliance Management System

(1) Preventative measures (cf. also section 1.3 on compliance organisation) are e.g.:

- regular staff training,
- drawing up guidelines and checklists,
- rules on authorising, deputising and signing.

(2) Detection measures could be:

- automatic plausibility checks, possibly computer-based;
- the "four eyes principle";
- reviews to ascertain whether or not staff are acquainted with the tax compliance programme.

» **Please note:** The effectiveness of the measures that are adopted has to be regularly reviewed. The result of a review can lead to adjustments to the tax compliance objectives and the tax compliance programme.

1.6 Tax compliance communication

Communication, which is frequently underrated, is probably the key component of a Tax CMS. This is because it is an essential requirement for staff and also any third parties involved to be acquainted with the objectives, rules, guidelines and processes and for training in this regard to be provided for them on a regular basis. Without such measures there can be no expectation that the above-mentioned guidelines will actually be complied with and that staff will understand their responsibilities and be able to fulfil them. Therefore, communication also has to be regulated in a Tax CMS.

Frequently, companies already have functioning structures through which they are able to publish announcements (e.g. intranet, e-mails, notices displayed on a board). In most cases, structures also already exist for defining and reviewing objectives. Therefore, if deployed sensibly, a Tax CMS can make use of such structures that already exist.

» **Please note:** In order to be able to provide proof of the effectiveness of a Tax CMS it will be necessary to document all communications (e.g. about the training and measures that were carried out).

1.7 Compliance monitoring and improvements

An existing Tax CMS should be reviewed regularly and, if necessary, improved. The review could focus on, for example, compliance with training requirements and their documentation, or adherence to defined process sequences. Such diligent controls should likewise be documented.

When rule violations are ascertained then the existing tax compliance arrangements should be scrutinised and, if necessary, adjusted. Likewise, adjustments should be made if there are any changes to the organisational structure or the company's business model.

» **Please note:** This means that the arrangements should scrutinised on a regular basis, not just in relation to specific events, and reviewed with respect to their effectiveness.

2. Taking into account individual tax risks

A reasonable analysis of the system as well as an appropriate evaluation of the existing Tax CMS will only be possible if the company's individual tax risks are taken into account. The requisite – at least broad-brush – analysis of these tax risks should therefore be performed on the basis of questions related to subject areas that are focused on the modules that are listed under section 3.

3. Result of the compliance analysis

Based on the compliance analysis, a decision will be taken as to which modules should be analysed in Phase II (cf. fig. 2 for the sequence of the phases). This Phase II then includes an analysis of the extent to which there are controls and measures for the single risks that could reduce the amount of a loss as well as the occurrence probability. These modules cover the following areas:

- the (German) Principles of Proper Keeping and Retention of Accounts, Records and Documents in Electronic Form as well as Access to Data (abbreviated in German to GoBD), including documentation relating to procedures and processes
- VAT, payroll tax/social security
- international tax law and transfer prices,
- tax on earnings and deferred taxes as well as
- customs

» **More Information:** In the next two issues of the PKF Newsletter we are going to present in detail, from the risk analysis phase, the modules related to GoBD and the area of payroll tax/social security.

WP StB [German public auditor and tax consultant] Thomas Rauert, StB [German tax consultant] Christian Knörndel

TAX

The taxation of excess returns under the US tax reform – Use of GILTI and FDII

With its “Tax Cut and Jobs Act“ the USA has repositioned itself as a response to international tax competition. The controversial body of legislation constitutes the most comprehensive overhaul of the US tax code since the “Tax Reform Act“ which was passed in 1986. The following report aims to provide you with a summary of two important new regulations in the US tax reform - the anti-abuse provision GILTI and its opposite, a preferential tax regime FDII. We discuss the explosive nature of the latter in connection with the German royalty barrier.

1. Objectives of GILTI and FDII

(The two above-mentioned regulations are supposed to create incentives for shifting profitable income sources to the USA. In this case, the US government has adopted a “carrot and stick” approach, i.e. on the one hand, it has provided an incentive via a tax concession to generate profitable income in the USA and, on the other hand, it has extended the scope of taxation of CFC income - this is directed against the generation of profitable income in low tax countries.

2. GILTI - an anti-abuse provision

With GILTI (Global Intangible Low-Taxed Income; Section 951A IRC) the USA has introduced taxation of CFC income that is directed against the practice of shifting income derived from intangible assets to low tax countries. If a foreign enterprise in which a US shareholder has a stake of at least 10% - a so-called Controlled Foreign Company (CFC) - generates profits that exceed the estimated routine return on their tangible property then the excess income shall be deemed to be income derived from intangible assets that has been shifted abroad. This will apply irrespectively of whether or not the CFC does indeed have intangible assets.
Consequently, the US shareholder will have to pay tax on this excess return as it shall be deemed to be GILT income. This CFC income will be subject to reduced taxation in the amount of 50% of the US corporation tax rate (21%) and a foreign tax credit will be allowed but will be limited to 80%. The tax rules adopt an aggregate approach for all the CFCs concerned so that offsetting is possible at the level of the US shareholder. By the same token, the rule also applies even if the CFC does not actually have any intangible assets.

3. FDII - a preferential tax regime

The new “anti-abuse provision” GILTI is flanked by concessions for export income generated by corporations based in the USA. This FDII rule assumes that the amount in excess of a US company’s routine return is derived from intangible assets. However, it is unimportant whether or not this excess return is actually derived from the use of intangible assets. The amount of FDII, which has to be calculated in several steps, corresponds to the share of the excess return that is proportionally attributable to the foreign business. US companies are allowed to deduct 37.5% of this amount from their assessment base for corporate tax purposes.
The remaining amount will be subject to US corporation tax at a rate of 21%. The FDII deduction means that the effective rate of corporation tax can thus be reduced down to as little as 13.125%.

4. Consequences for taxation under German law

From a German perspective, the question that arises is whether or not the FDII rule is a harmful preferential (tax) regime within the meaning of Section 4j of the German Income Tax Act (Einkommenssteuergesetz, EStG) under which royalty payments are not, or not fully, tax deductible in Germany if the income is taxed in a foreign country at a rate of below 25%.
The newly introduced royalty barrier in Section 4j of EStG is problematic in view of the fact that the term “preferential regime” has not been defined sufficiently

Incentives for shifting profitable income sources to the USA

specifically. Accordingly, there are difficulties in connection with, for example, the FDII rule in the USA when it comes to classifying whether or not this rule does indeed constitute such a harmful preferential regime. At first glance, the effective tax rate of just 13.125% (low taxation) would appear to be indicative of the existence of a preferential regime. Recommendation: Attempts at interpreting the legislation have already been published in the specialist literature. Ultimately, however, we will have to wait for an opinion statement from the tax authorities as to whether or not the tax break for FDII could potentially result in the royalty barrier being applied in Germany. If this were accepted as being the case then German companies would not be able, for example, to deduct, as business expenses, the royalty payments made to their US parent companies.

WP StB [German public auditor and tax consultant] Dr Matthias Heinrich, Julia Hellwig

Allocation to a permanent establishment and the final effect of withholding tax in the case of a German limited partnership (KG) deemed to be of a commercial nature and in the absence of a DTA

Who for: Foreign corporations and natural persons (mainly from states without a DTA) who have shareholdings in domestic (German) corporations.

Issue: Section 8b of the German Corporation Tax Act, to a great extent, protects German corporate groups from the so-called cascading effect of taxation via a 95% tax exemption on profit distributions, so that the tax rate in these cases is ultimately approx.1.5%. However, dividends paid to foreign corporations that do not have a “domestic (German) operation” are not eligible for tax concessions in this case. The deduction of capital gains tax definitively settles the tax liability and thus, in the base case, this results in a (withholding) tax burden of approx. 25%.

In practical tax planning, this situation has been dealt with by interposing a German GmbH & Co. KG (a German limited partnership with a limited liability company as a general partner) deemed to be of a commercial nature in order to create a “domestic (German) operation”. The Federal Fiscal Court (Bundesfinanzhof, BFH) had to make a decision on just such a case in its ruling from 29.11.2017 (case reference: I R 58/15). Here, first of all, the BFH established that not only the original commercial GmbH & Co. KG but also one deemed to be of a commercial nature could function as a “domestic (German) operation” for the foreign shareholder. However, another requirement was that the shareholding from which the dividend was derived should also be attributable to this “domestic (German) operation”. This attribution for tax purposes should (only) be made for economic reasons. Ownership under civil law is not a determinant. Attribution for tax purposes to a permanent establishment or a head office could thus differ from the (indisputable) attribution under civil law to the GmbH & Co. KG.

Please note: The structuring arrangements based on a domestic GmbH & Co. KG would be interesting not only in a situation where there is no DTA - as in the case in question - but also for shareholders from countries with a DTA. The high level of definitive taxation is frequently reduced on the basis of provisions in the DTA. These sometimes significantly limit the right to withhold tax at source (article 10(2) of the OECD Model Tax Convention). Indeed, withholding tax between European countries has even been basically completely abolished through the Parent-Subsidiary Directive (PSD) (Article 5 PSD was transposed into German law in Section 43b(1) of the German Income Tax Act (Einkommenssteuergesetz, EStG). However, these moderations or exemptions were tied to the (strict) and, in some cases, excessive substance requirements under Section 50d(3) EStG that, frequently, could not be met or necessitated complicated documentation. Nevertheless, it was still possible to circumvent these requirements by interposing a domestic (German) GmbH & Co. KG.

The key outcome is that, in the future, ownership under civil law of the GmbH & Co. KG on its own will no longer be sufficient, but instead it will be necessary to establish an instigating relationship between the shareholding and the GmbH & Co. KG. It is still not clear what criteria would be used as a basis for assessing this instigating relationship with respect to inland or abroad. The BFH did not have to comment on this due to the lack of facts in this respect. The question could potentially be based on, among other things, who carries out the management of the shareholding, or if and to what extent there actually are any assets inland or abroad. Furthermore, foreign natural persons from states without a DTA frequently use the structure of a GmbH & Co. KG to avoid disjunction. Such cases will also potentially have to be reassessed.

Conclusion: While, the BFH ultimately basically approved the structuring arrangements, nevertheless, it tightened up the requirements. In tax audits, in specific cases, there will be much to argue about with respect to the vague criterion of the instigating relationship - unlike in the case of ownership under civil law.

StB [German tax consultant] Dr Maximilian Bannes

Merging a profitable company with a loss-making one does not constitute abusive tax structuring

» Who for: Taxpayers who are faced with the accusation of abusing tax structuring options within the meaning of Section 42 of the (German) Fiscal Code *(Abgabenordnung, AO)* and who have to exonerate themselves, or wish to perform an ex-ante check to see whether or not tax structures are abusive.

» Issue: The Hessen tax court, in its ruling from 29.11.2017, made a decision regarding the existence of an abusive tax structure within the meaning of Section 42 AO in the case of a retroactive merger of a profitable company with a loss-making one. In the case in question, a company with a high level of current profits was sold in an arm's length transaction and then subsequently merged - with retroactive effect for tax purposes - with the purchasing company, which had unused tax losses. Thereafter, due to the retroactive effect for tax purposes, the purchasing company was able to offset its losses against the current profits of the company with which it had merged (retroactively taking into account the income of the transferred company for the loss-making acquirer is now precluded under Section 2(4) clause 3 et seq. of the German Reorganisation Tax Act *(Umwandlungssteuergesetz,UmwStG))*.

There was a dispute between the local tax office and the taxpayer as to whether or not the merger in question constituted abusive tax structuring within the meaning of Section 42 AO. The Hessen tax court rejected this and justified its view, in particular, by adopting and continuing with the basic arguments of the Federal Fiscal Court in its ruling from 18.12.2013 (case reference: I R 25/12) on how the special anti-abuse rules are related to Section 42 AO. A key aspect of this ruling is that special anti-abuse rules have a blocking/screening effect in relation to the general concept of abuse set out in Section 42 AO. The adequacy of a structure should be considered on the basis of the individual tax law that has been "circumvented" along with the flanking (special) anti-abuse rules.

If the legislator has already issued special rules to cover a field where abuse is suspected then assessment criteria will have already been specified for that particular area and consistent application of the law will have been ensured so that certainty can be guaranteed for those types of structures. If the requirements for the anti-abuse provisions are not fulfilled accordingly (in this case: Section 12(3) UmwStG, Section 8c of German Corporation Tax Act *(Körperschaftsteuergesetz, KStG))* then the legislator's assessment should not be bypassed through the extensive application of Section 42 AO (old version). Therefore, despite Section 42(1) clause 3 AO, the rules in the special legislation should then not be eroded through the use of Section 42 AO. The principle that does apply is that more specialised rules should override the more general ones. If any gaps remain in terms of the legal consequences then it is solely the responsibility of the legislator to close these gaps up.

That is why, in the case in question, an unreasonable structure could be excluded because the rules in Section 12(3) UmwStG and Section 8c KStG conflicted with this concept. According to the Hessen tax court, from both of these provisions it was clear that the legislator had recognised the problem of the abusive use of losses in reorganisation cases.

» Conclusion: Ultimately, the Hessen tax court thus put forward various arguments in favour of the 'lex specialis' principle in the context of tax structuring and Section 42 AO. This section should then only be applied if the special rules are not of a definitive nature.

More Information: The ruling of the Hessen tax court from 29.11.2017, with the case reference: 4 K 127/15, was published in the EFG2018 (*Entscheidungen der Finanzgerichte*, or Tax Court Decisions) on page 486 (appeal permitted).

WP StB [German public auditor and tax consultant] Dr Matthias Heinrich

Restructuring Decree - The constitutional court will rule on legacy cases

It is the opinion of the tax authorities that tax concessions available under the rules of the Restructuring Decree should continue to apply to debt waivers that were granted for corporate restructuring purposes up to 8.2.2017 (legacy cases). The Federal Fiscal Court (BFH) had initially declared that the Restructuring Decree was unlawful. By contrast, the Federal Ministry of Finance), in its circular from 27.4.2017, had formulated a protection of legitimate expectation provision for legacy cases. The BFH has challenged the applicability of this protection of legitimate expectation provision. A constitutional complaint was lodged by the BFH on 20.3.2018 (case ref.: 2 BvR 2637/17) against the Restructuring Decree and the protection of legitimate expectation provision.

1. Restructuring Decree from 2003

The so-called Restructuring Decree (Bundesministerium der Finanzen, BMF circular from 27.3.2003; supplemented by the circular from 22.12.2009), as generally binding administrative guidance, opened up the possibility of tax waivers on "restructuring profits" for objective equitable reasons. The tax concession that was made available concerned the profits that arose for a company when

its creditors waived their debt claims for the purpose of restructuring (restructuring profits). The conditions for the presumption of tax-privileged “restructuring profits” were deemed to be:

- a need for restructuring by the business,
- a full or partial debt waiver,
- restructuring was the intention of the creditors,
- the debt waiver was appropriate for restructuring.

It is the opinion of the BFH that the Restructuring Decree constitutes a violation of the principle of the legality of administrative actions (ruling from 28.11.2017, case reference: GrS 1/15,). Accordingly, equitable measures are always based on individual cases while the Restructuring Decree makes a generalisation in a non-permissible way. The tax authorities do not have the latitude to waive tax claims at their discretion. With the publication of this BFH ruling, on 8.2.2017, the Restructuring Decree was thus deemed to be unlawful.

2. Statutory provisions for new cases as of 8.2.2017

The introduction of Section 3a of the German Income Tax Act and Section 7b of the Industry and Trade Tax Code, on 27.6.2017, provided legal provisions to regulate the tax exemption for income from debt waivers granted for the purpose of a company-related restructuring. These rules were supposed to be applied, for the first time, to debt waivers after 8.2.2017. However, these new cases are still subject to a review by the European Commission to determine whether or not the tax concession constitutes unlawful state aid.

3. Protection of legitimate expectations provided by the tax authorities ...

The BMF ordered that the Restructuring Decree should continue to be applied in cases where the debt waiver by the creditors involved in the restructuring of a company had been definitively carried out before 8.2.2017 (protection of legitimate expectations in accordance with the BMF circular from 27.4.2017). Moreover, binding information or assurances that had been provided could not be withdrawn.

... was overturned by the BFH

In the opinion of the BFH, there is no legal basis for this BMF circular either (ruling from 23.8.2017, case reference: IR52/14 and XR38/15) (cf. indication in PKF Newsletter 12/2017). If the original Restructuring Decree from the tax authorities constituted a violation of the principle of the legality of administrative actions then the same would also be true of the BMF circular from 27.4.2017. Transitional arrangements for legacy cases could only have been made by the legislator. As this did not happen it would only be possible to grant tax relief for “restructuring profits” in extreme individual cases, or if there were personal equitable reasons. This is why the Restructuring Decree and the protection of legitimate expectation clause have been submitted to the Federal Constitutional Court for a review. However, the BMF has remained unperturbed and, on 29.3.2018, ordered the non-application of the BFH rulings from 23.8.2017 beyond individual cases (case reference: IV C 6 - S 2140/13/10003).

» **Recommendation:** Legacy cases, in particular, where there have been debt waiver procedures for restructuring purposes should be held open. In individual cases you should have evidence available of the existence of the preconditions for fairness.

StBin [German tax consultant]
Sabine Rössler, Duisburg

Allocation, for tax purposes, of revenues from sales transactions on eBay

» **Who for:** Private individuals and (small) businesses that use eBay and similar services as sales platforms.

» **Issue:** : It is not uncommon for several people to use a single account with online auction platforms in order to sell items. From a VAT perspective, this could become a pitfall if the overall level of all the sales transactions executed via just one username breaches the revenue thresholds for small businesses. The Baden-Wuerttemberg tax court, in its ruling from 26.10.2017 (case reference: 1 K 2431/17), decided that, from a tax perspective, sale transactions liable to VAT that have been executed by several individuals using a single common username have to be attributed to the person who is the user account holder vis à vis eBay. This person shall be deemed to be the business owner within the meaning of the German VAT Act. An inner willingness to settle other sale transactions via the user account will not be taken into consideration.

Joint user accounts should be avoided at all costs.

The person who should be regarded as the supplier in a transaction - and thus the busi-

ness owner as well as the one who is liable to pay the VAT due - is usually shown in the agreements concluded under civil law. Normally, this is the person who supplies goods or services to another person in his/her own name him/herself or through a contractor. That is why attribution basically depends on whether, vis à vis the recipient of the goods or services, the agent is acting in his/her own name, or is entitled to do so in the name of another person. The person who is liable to pay the VAT that becomes due on an exchange of services is, thus, the person who appears externally as the supplying business. When a contract is concluded via eBay, the contractual partner of the highest bidder and, thus, the supplier of the goods or services within the meaning of VAT law is the person under whose name the binding sales offer was submitted. According to the so-called objective viewpoint of the recipient, the crucial point here is how the offer is displayed on the website. If, as in the case in question, the auction happens in a process where only a username is used then the contractual partner will be the person who had this anonymous username assigned to him/herself.

If there is a dispute, the buyer is entitled to be given the name only of the person behind the username. If there are any breaches of contract then, under civil law, claims for the performance of the contract can only be asserted against this person. By contrast, eBay is not usually aware of the person who has actually (physically) posted the offer for sale.

» **Recommendation:** For the purpose of clearly delimiting sales transactions it is advisable not to hold a user account jointly for private and business purposes and not one that can be used by several people at the same time.

More Information: Further details about the decision by the Baden-Wuerttemberg tax court can be found in press release no. 6/2018 from 4.4.2018.

StB [German tax consultant]
Dennis Brügge, Marc Hendrik Finke

LEGAL

Better protection for whistleblowers within companies and public authorities

» **Who for:** Employers and employees who agree non-compete clauses.

» **Issue:** In order to better protect whistleblowers from being sanctioned by the state and by corporations the EU Commission published a proposed directive that includes various protective mechanisms. Whistleblowers are people who expose statutory violations, in companies or organisations, that harm the general public. Up to now, protection for whistleblowers provided by companies has been regulated differently across the EU. In fact, whistleblowers, even if they do not act with malicious or improper intent, frequently have to expect serious consequences from both the state (e.g. criminal prosecution) as well as the company itself through retaliatory measures.

Protection when reporting statutory violations

The EU Commission's proposal provides for a three-tier reporting system.

- First of all, whistleblowers should be given the opportunity to broach the subject of statutory violations through internal channels.
- If the internal process does not achieve success then, in the future, whistleblowers should be given the opportunity of reporting statutory violations to state supervisory authorities.
- If this way does not lead to any success either then public or media reporting should be permitted.

Under the proposed directive, there would be express feedback obligations for companies and authorities. Furthermore, all forms of retaliation against the whistleblower would be forbidden. If a whistleblower is nevertheless sanctioned, then s/he would have to be given access to free legal advice and adequate remedies and also be sufficiently protected in judicial proceedings. Moreover, the burden of proof would be reversed, i.e. the companies or organisations concerned would have to prove that they had not adopted any retaliatory measures. The enhanced protection would have to be fully applicable and not just granted to

employees but also to, e.g., contractors, suppliers, interns and job applicants. The proposed directive would affect all companies with more than 50 employees or with an annual turnover of over €10 m. Moreover, this proposal would affect state and regional administrations and municipalities with more than 10,000 inhabitants.

Recommendation: Companies should review the proposed EU directive for better protection for whistleblowers, in particular, its applicability from a compliance perspective - which is becoming increasingly more important - and then take preventative action.

RA [German lawyer]
Dr Michael Rutemöller

ECJ - Stand-by duty is working time but on-call duty is not

Who for: Employers and employees with on-call working times.

Issue: If employees have to be available on call for work assignments for certain periods, a question that usually arises is how should these periods of time be treated under employment law. The ECJ recently used the case of a Belgian firefighter to define more precisely the basic principles that should be considered here (judgement from 21.2.2018, case reference: C-518/15).

The firefighter was required to be available on call for work for one week every month during the evenings and at the weekend. In the event of an emergency call he would have to appear at the fire station within eight minutes. According to the court, this case was not about on-call duty as generally defined under employment law but about stand-by duty, which should be regarded as working time. The crucial point here was that the requirement for the employee to appear at short notice effectively specified where he had stay in order to be able to perform his work immediately if required. As a consequence, he was impeded from spending time on his personal and social interests, which is why these stand-by times could not be regarded as rest periods.

By implication, on-call duty can thus be deemed to be a rest period if the employee is not required to be in a specific location and merely has to be reachable so that he can commence working when he gets a call.

Classifying stand-by time as working time would, in particular, have effects on the restrictions under the Working Hours Act which would have to be considered.

Likewise, there is a requirement to pay remuneration for these times, although an amount that is less than that paid for the actual work performance could be agreed.

However, the level may not fall below that of the minimum wage, as already decided by the Federal Court of Justice in its ruling from 29.6.2016.

Recommendation: If employees are expected to be on call or on stand by then specific rules with respect to the arrangements and remuneration should be included in the employment contract. Naturally, mandatory legal regulations should be taken into account in this process.

RA StB [German lawyer and tax consultant] Frank Moormann

Stand-by duty as working time

ACCOUNTING & FINANCE

The effects of digitisation on company valuations

The digital transformation of business models and processes also encompasses accounting and controlling, including business planning, corporate steering and company valuations. Traditional valuation processes, which have proved their worth in practice, have to be adapted to these special requirements.

1. Taking uncertainty into account

With the accepted present value-oriented company valuation methods - such as, for example, the discounted cash flow technique - a company's value is calculated by discounting expected future cash flows. As digitisation is associated with a strong evolution in business models and processes, forecasts for future earnings will be subject to greater requirements due to the uncertainty that this involves.

1.2 Analyses of the past

In principle, a company's historical business development does not affect its value, as it is the future cash flows that are relevant here. However, in order to identify the main influencing factors and the so-called value drivers for the business model, normally, analyses of the past are carried out. In this case, a backward-looking analysis of the business development is made with regard to the future earnings power. The digital transformation can lead to sources of income, which were successful in the past, undergoing changes or, potentially, completely drying up. Notable examples of this are the music industry or newspaper publishers where the transformation led to a turning away from physical products (CDs, advertisements) and towards digital ones. It is for these reasons that, in particular, new value drivers, which can be expected to emerge as a result of the transformation, should also be identified and forecasts created for them.

1.2 Financial projection

Financial projections are drawn up within the framework of forecasts of future earnings. In this context, the initial plan years are planned in detail - accordingly, there is an explicit forecast for the values in phase I and, in phase II, there is a switch to the perpetuity formula. Digitisation can lead to very quick changes in the main influencing variables, such as the market and competitive environments, and would thus be reflected in the plan.

It would not be appropriate to switch to a perpetuity formula until the so-called state of equilibrium has been reached (this is defined as a period with steady free cash flows adjusted for positive and negative swings). In these cases, the financial projection should instead be supplemented with a phase that transitions to the perpetuity formula until a state of equilibrium can be expected. If significant changes (due to digitisation) are expected already in the detailed planning phase then these should be depicted in scenario analyses. In this regard, the financial projections for companies whose business models are undergoing a digital transformation resemble those of fast-growing companies or start-ups in the growth and maturity phases. As a general rule, past results do not provide an appropriate basis for a forecast of future developments and for incorporating plausibility considerations. In these cases, the evolution is fast and, at the same time, there is great uncertainty.

Forecasts of future cash flows and, in particular, the state of equilibrium are subject to considerable uncertainty and fluctuations and have a concomitant high degree of sensitivity to changes in the forecast parameters. That is why the financial projection should be carried out on the basis of expected market shares, forecast margins and market sizes and, in particular, it should take into account the following factors:

- the long-term marketability and competitiveness of the product and service ranges,
- the availability of resources,
- the adjustments that need to be made to the internal organisation as a consequence of growth,
- the viability of financing as well as
- the requisite (for the company's growth) scalability of the business model,
- furthermore, a growth discount should be applied to duly take account of the particularities of a (fast-) growing company.

2. Capitalisation

With present value-oriented company valuation techniques a risk-adjusted discount rate is applied to expected future cash flows in order to discount them back to a valuation cut-off date. The discount rate is usually determined on the basis of the Capital Asset Pricing Model (CAPM). In this case, the cost of equity capital is determined from the sum of the risk-free base rate and the company-specific risk premium. The latter is derived from the product of the

market risk premium and the so-called beta factor, which is regarded as a measure of company-specific risk.
In this respect, the common practice is to derive the beta (also) on the basis of historic capital market data on the assumption that betas are relatively constant over time and that these findings can be carried over into the future. At this point the question arises as to whether or not historical value observations would be appropriate if the business models and processes have undergone disruptive changes in some cases. Changes could be taken into account in scenarios when determining the beta factor or the discount rate.

Disruptive changes to business activities affect company valuations

3. Conclusion

Even within the framework of a digital transformation of business models and processes the basic principles of company valuation do indeed remain valid. However, when determining future earnings new challenges are emerging with respect to the appropriate planning of future profit contributions. If business models change then analyses of the past will only be of limited significance.
In this respect, it will only be possible to achieve meaningful company valuations by adequately taking into account future digital value drivers and by giving due consideration to the potentially decreasing contributions to value from "old" business models. Furthermore, additional uncertainty factors will have to be taken into account when creating a financial projection and determining a discount rate.

WP StB [German public auditor and tax consultant] Patrick Niebuhr

LATEST REPORTS

Interest on tax arrears – Will the rate remain at 6% p.a.?

The Federal Fiscal Court (Bundesfinanzhof, BFH), in it ruling from 25.4.2018 (case reference: IX B 21/18) challenged the constitutionality of interest on tax arrears. The court argued that the assessment for the interest rate was unrealistic, as the statutory interest rate of 6% p.a. significantly exceeds the appropriate boundaries of the economic reality of the current low interest rate phase. In view of the general principle of equality and the prohibition of disproportionate measures there are serious doubts with respect to compatibility with constitutional law. This concerns interest rates from 2015 onwards.

You should file an application to defer execution and for a suspension of proceedings with reference to the various cases pending at the BFH (e.g. under case reference III R 25/17) as well as the current constitutional complaints at the Federal Constitutional Court (case reference: 1 BvR 2237/14 and 1 BvR 2422/17).

Payroll tax – Provision of company motor vehicles to employees for their use

In a circular from 4.4.2018, the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) expressed its opinion and/or summarised BMF circulars that it had already issued on the payroll tax treatment of company motor vehicles provided to employees for their use. These clarified the rules, in particular, for the topics of journeys home, vehicle pools, the relevant list price as well as a driver's electronic log

book. For example, if in a vehicle pool there are several motor vehicles available to an employee then the flat rate of the value in use will be calculated at 1% or 0.03% of the list price of all the motor vehicles; this sum will have to be divided by the appropriate number of authorised users.

Medical costs cannot be deducted as a special expense

The Federal Fiscal Court (Bundesfinanzhof, BFH), in its ruling from 27.9.2017, decided that medical costs paid by taxpayers themselves cannot be considered as a special expense deduction. In the case in question, the claimant had borne his own medical costs in order to get a refund of his health insurance premiums. In his tax return, the claimant had deducted the medical costs that he had borne himself from the refunds so that the medical costs paid by him would increase the amount of the special expense deduction and thus generate a benefit for him. However, only medical insurance premiums can be deducted as special expenses.

» **Please note:** If the reasonable level for an individual burden has been exceeded then the medical costs can be deducted as extraordinary burdens.

AND FINALLY...

„It ‚s always right to lower taxes - in every country, at all times and for any reason. All taxes are too high and all governments are too fat. They should drive down taxes to as low as they can go.“

Milton Friedman, US American economist and Nobel prize-winner, 31.7.1912 – 16.11.2006.

Impressum

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