PKF

Newsletter

Key Issue:

Brexit and VAT

Changes to which businesses will now urgently have to adapt

03|19

PKF

Dear Readers,

At the end of February it was still not clear whether or not and on which contractual basis the United Kingdom would leave the EU at the end of March. In view of failed attempts to get a Brexit deal through the UK Parliament, a **“soft Brexit“** with a negotiated settlement that would lead to a free trade agreement appears to be as unlikely as a **“no Brexit“** scenario, where the UK would end up staying in the EU. Instead, we will have to brace ourselves for a **“hard Brexit“** with **“no deal“**. This would then be the worst-case scenario for businesses, one where EU law would no longer in any way be applicable and trade would be conducted on the basis of WTO rules. In actual fact, to a large extent the Brexit issues have not been fully worked through. We would like to provide some support in this respect with two articles.

In the Tax section, (nearly) everything revolves around **value-added tax**. First of all, we discuss the current legal situation with respect to the treatment of **bonus point programmes**. This is followed by an overview of the new requirements for operators of and traders with a presence on **online marketplaces**. These rules have been applicable since 1.1.2019. Next up is our Key Issue for this edition - **the impact of Brexit on value-added tax from the point of view of the EU**. Only “no Brexit” will be able to prevent the United Kingdom from becoming a third country as of 30.3.2019 and being able to shape its VAT law as desired. In any case, the VAT Directive will no longer be applicable. We have juxtaposed the main changes that would arise from the **switch from being an EU member state to a third country**. Following on from that is a report on what should be borne in mind with a view to **salvaging loss carry-forwards** for offsetting against corporate tax and this rounds off our tax news section.

We start off the Legal section with the question of whether or not a **managing director** with a shareholding of less than 50% may be **exempted from social security contributions**. We subsequently discuss a court ruling that sets out the (narrow) limits within which the **exclusion of a shareholder** would be possible. And finally, on the topic of the consequences of Brexit, we report on what will become **of those limited companies that were set up under UK law** if they are based in Germany and how their shareholders can **avoid unlimited liability**.

In the Accounting & Finance section, we take a look at the question of the point at which a **warranty provision** would have to be recognised. According to a recent Federal Fiscal Court ruling there are, namely, **limits** also to adjusting events.

With our best wishes for an interesting read,

Your Team at PKF

Key Issue

Brexit and VAT – Changes to which businesses will now urgently have to adapt

Contents

Tax

VAT assessment base for bonus point systems coming under review shortly at the Federal Fiscal Court 4

VAT in online retailing – New rules since 1.1.2019 5

Brexit and VAT – Changes to which businesses will now urgently have to adapt 7

Loss carry-forward tied to the continuation of a business in accordance with Sec. 8d of the German Corporation Tax Act – Filing the application 10

Legal

The social insurance payment obligation of a minority shareholder of a GmbH (private limited company) 10

The conditions for an effective exclusion of a shareholder 11

Brexit and the Ltd – The way out of the British legal form 12

Accounting & Finance

Warranty provisions – seriousness with respect to use and adjusting events 14

Latest Reports

No taxation of excess withdrawals in the case of contributions 15

(Non-)expiry of leave 15

TAX

RA [German lawyer] Dr Michael Rutemöller

VAT assessment base for bonus point systems coming under review shortly at the Federal Fiscal Court

Bonus point systems are very popular with many companies. However, the VAT treatment of these customer loyalty programmes is still largely unclear on many aspects and, thus, frequently the subject of current court rulings.

1. Classification of customer loyalty programmes

The customer loyalty programmes that are used in practice can be organised in different ways.

(1) Programmes where the supply relationships of the customers are exclusively with the retailers and not with the bonus points providers (hereinafter: providers) themselves. Such programmes were dealt with by the Münster tax court in its ruling from 14.11.2017 (case reference: 15 K 281/14 U). The contractual agreements of a bonus point system were judged to be such that providers render services solely to the participating retailers and not, however, to the end customers. In this instance, the VAT treatment in the case of non-redemption or expiry of the granted bonus points on the part of the customers is especially problematic. In the opinion of the court, bonus points that are ultimately not redeemed are debited against the providers and, as a consequence of this, there is an increase in the VAT assessment base for services to the retailers. The tax authorities have lodged an appeal with the Federal Fiscal Court (Bundesfinanzhof, BFH) against this decision (case reference: V R 64/17).

(2) A distinction has to be made in the case of programmes where supply relationships exist between providers and customers (for example, Payback, Deutschland Card, Miles & More). Within the scope of these programmes,

by making purchases from affiliated partner companies the customers are able to collect sales-dependent points that, on the basis of contractual supply relationships with the providers, are then credited to the points accounts maintained specifically for these customers. Customers are able to redeem these points to pay for subsequent purchases. Yet, according to legal rulings and the tax authorities, granting bonus points does not automatically establish a VAT-relevant transaction (pursuant to the principles of so-called multi-purpose vouchers). On the part of the provider, supplies or services to customers that are liable to VAT can only be realised if customers have actually been redeemed bonus points in the course of a subsequent purchase (e.g. against non-cash rewards or vouchers).

Unlike the above-mentioned variant (1), the non-redemption or expiry of the granted bonus points would not have a detrimental effect on the providers because this is not of relevance for VAT purposes. From a VAT perspective, providers granting bonus points is not relevant (an inconsequential issuance of a cash equivalent). Likewise, the original supply for which the bonus points were granted, initially, has to be fully taxed (the corresponding input tax is fully deductible). However, with respect to the original supply, a (subsequent) reduction in the VAT assessment base has to be taken into account. It is however questionable at which point in time this would be the case.

2. Timing of the reduction of the assessment base

The Munich tax court – likewise in a relatively recent ruling from 23.8.2017 (case reference: 3 K 1271/16) – was of the view that the assessment base for the original supply should be reduced already at the point in time when the affiliated partner company has to settle the value of the bonus points granted for this supply vis à vis the provider (the so-called points clearing). By contrast, the tax authorities (e.g. the Frankfurt/Main regional tax office from 5.11.2012) do not acknowledge a reduction in the assessment base for the original supply until the point in time when the customer actually redeems the bonus points that s/he received from this supply. The tax authorities have lodged an appeal with the BFH against the decision of the Munich tax court, too, (case reference: V R 42/17). It remains to be seen which view the BFH will prefer as regards the timing of the reduction in the assessment base.

Recommendation

When implementing a bonus point system – in view of the complexity and the considerable number of VAT problem areas – you should always seek support and advice from specialist consultants and should allow them to monitor this process.

StBin [German tax consultant] Elena Müller

VAT in online retailing – New rules since 1.1.2019

Under the Tax Act for the Prevention of VAT Revenue Losses from Trading in Goods over the Internet and Amendment of Further Tax Provisions (Federal Law Gazette (Bundesgesetzblatt, BGBl) I 2018, p. 2338), the operators of electronic marketplaces have been subject to specific obligations since 1.1.2019. These have important consequences not only for the operators themselves but also for the online traders.

1. Obligations of marketplace operators

The new regulations relate, firstly, to data collection requirements and, secondly, to liability issues.

(1) Data collection – Marketplace operators have to produce tax registration certificates for those traders that are active on their marketplaces (cf. next section 2). Furthermore, the operators are obliged to record specific information about the transactions of these traders. If the trader is not a business then, instead of a certificate, s/he has to disclose his/her name and complete address as well as – for the purpose of unambiguous identification – his/her date of birth. The information that has to be recorded has to be retained for a period of ten years.

(2) Liability – Marketplace operators will be liable for any VAT that arises in connection with trading on their internet platforms that is not paid by the online traders. This liability ceases if the operator has all the prescribed information and documents and is able to provide them to the local tax office. If the supplying business is not complying with its tax obligations then the local tax office will notify the operator of this. Subsequently, the

operator will have to ensure that the supplying business is no longer able to offer its goods on that marketplace. Only then will the operator of an electronic marketplace not be made liable.

2. Consequences for online suppliers

Online traders have to apply to their competent tax offices for the certificate as defined in Section 22(1) clause 2 of the German VAT Act (Umsatzsteuergesetz, UStG) stating that they are taxable persons (businesses). It is possible to apply for such a certificate without a completing form simply by writing a letter or via e-mail.

Please note: The Federal Ministry of Finance has now published a model form USt 1 TJ. Traders now have a legal entitlement to a certificate being issued. It will be issued on a transitional basis in paper form and will be valid at most until 31.12.2021.

Upon application, even small businesses will receive, from the competent tax office, a certificate of their tax registration, in accordance with Section 19 UStG, that they can present to marketplace operators. A business that does not carry out any taxable inland transactions does not have to apply for a certificate (cf. Federal Ministry of Finance circular from 28.1.2019).

Please note: Transitional periods apply to the new liability rules that relate to marketplace operators. Traders from a third country will be subject to the potential liability from 1.3.2019 and traders from EU/EEA states from 1.10.2019.

Recommendation

Online Traders that offer their goods on electronic marketplaces, such as Amazon and eBay, should file their applications as quickly as possible and provide the certificates that they receive to the marketplace operators. Otherwise, the operators will block the dealers in order not to incur the liability risk.

StB [German tax consultant] Marco Herrmann

Brexit and VAT – Changes to which businesses will now urgently have to adapt

VAT law in the EU is considered to have been extensively harmonised through the EU Directive on the VAT system. Once Brexit has been accomplished, this harmonisation in relation to the United Kingdom of Great Britain and Northern Ireland (GB) will automatically cease. This will result in far-reaching changes in the way VAT is charged on business transactions between GB and Germany. To-date, the German legislator, in its draft of the Brexit Accompanying Tax Act (Lower house of German parliament (Bundestag, BT) printed matter: 19/7377) has not provided for any transitional rules to mitigate the impact of this and, moreover, the future arrangements under British tax law are not yet known. Businesses would therefore be well advised to ascertain what action is required with respect to VAT and to prepare the necessary organisational and contractual adjustments. In the course of this, the following 14 major changes, in particular, should be taken into consideration.

(1) British VAT identification numbers (VATIN) will cease to be valid. Where necessary, the commercial status of British business partners will therefore have to be evidenced in another way (e.g. an attestation from a British authority confirming that the business partner is a commercial operator).

(2) In the case of **goods supplied to GB**, in the future, these will no longer be deemed to be intra-Community (i-C.) supplies but rather export deliveries. These can be exempt from VAT if the prescribed obligations to provide documentary evidence are fulfilled. To this end, the electronic export notice from the competent customs authority (instead of the entry certificate that is prescribed for i-C. supplies) will have to be retained. Moreover, the tax exemption for export deliveries will have to be mentioned on the invoices (instead of the tax exemption for i-C. supplies). Export deliveries should not be reported in the recapitulative statement (RS) or to Intrastat.

(3) Mail **order businesses catering to British private individuals** (for example, via Amazon) will no longer be subject to the special rules under Section 3c of the German VAT Act *(Umsatzsteuergesetz, UStG)* (it is currently still the case that once the British threshold of sales is breached then the place of supply shifts to GB). It is not known whether or not GB will introduce national rules for mail order businesses catering to private individuals.

(4) For all exports of goods from the EU, the **obligations with respect to customs law** will have to be complied with and the responsibilities in this respect will have to be contractually agreed with the business partners.

(5) Goods supplies from GB will no longer have to be taxed by businesses as i-C. purchases. Furthermore, the obligation to report to Intrastat would cease. Instead, the goods will have to be imported into the EU in accordance with customs law. The import will be subject to import sales tax (IST).

Please note: Only the business that has the authority to dispose of the goods when they are imported will be able to deduct the input IST (subject to other requirements). The transfer of the authority to dispose of the goods should thus be contractually regulated beforehand. If the supplier is liable to pay the IST then, apart from the import, the delivery itself will also be subject to VAT in Germany (shift of the place of supply to the country of destination). In such a case, British suppliers would have to register for tax purposes in Germany, charge German VAT (if no tax exemption provision applies) and fulfil their tax declaration obligations.

(6) In the case of **chain transactions** (= where several companies conclude trading transactions relating to the same item and it is transported directly from the first business to the final customer) it will be necessary to check which stage of the supply within the chain has to be assigned to the amended legal and, potentially, contractual conditions of the goods transport and can, therefore, enjoy the tax exemption for export deliveries.

Please note: The simplifications for i-C. **triangular transactions** will no longer be applicable once Brexit has been accomplished.

(7) Intracompany **movements of goods** to GB or from GB to Germany should no longer be declared as a notional i-C. supply and/or notional i-C. purchase. As a consequence, the reporting requirements in the RS and for Intrastat will also cease to apply. Instead, the provisions

under customs law and import tax law will have to be taken into account.

Please note: In specific cases (e.g. for **only a temporary use of the goods** in the EU customs territory), simplifying methods under customs law could apply that would avoid IST having to be assessed.

(8) For **deliveries via consignment stock**, the action that the customer will need to take, based on the changes described above, will depend on whether the warehousing of the goods is still judged to be an intra-company movement, or already a delivery to the customer (cf. PKF Newsletter 1/2018 and 4/2018).

(9) For the **movement of services between German and British businesses**, the receiver location principle will normally apply even after Brexit has been accomplished. However, the reporting obligation in the RS would cease. In accordance with this principle, if the services take place in Germany then, normally, the recipient of these services would bear the VAT liability (reverse charge mechanism).

Please note: It is currently not known whether or not the tax liability will be transferred to recipients of services if these are carried out in GB.

(10) Specific **services for non-business customers** in GB (e.g. legal advice; moreover, cf. so-called catalogue services pursuant to Section 3a(4) clause 2 UStG), once Brexit has been accomplished, will no longer be subject to German VAT but, instead, British VAT. This will potentially require the supplying businesses to register for tax purposes in GB and deal with British tax declaration obligations.

(11) Tax obligations arising from **services supplied electronically** (e.g. streaming services, downloading of images and music) by German businesses to British private individuals, or British businesses to German private individuals will no longer be able to be dealt with

using the simplified mini One Stop Shop system (MOSS system). Instead, British businesses will be able to participate in the One Stop Shop system for third country businesses.

(12) After Brexit, **the input tax refund applications** of British businesses will have to be submitted to the Federal Central Tax Office within six months after the end of the calendar year. The rule for EU businesses, according to which an application can be filed within nine months, will no longer be applicable. The prerequisite for tax refunds for British businesses will continue to be GB's future willingness likewise to refund VAT to German businesses.

(13) After Brexit has been accomplished, there will also be major VAT changes, in particular, for specific **rental services, trade fair services and travel services** as well as for trade in **second-hand goods** and **works of art** (VAT margin scheme).

(14) Furthermore, it should be noted that, after Brexit, **storing invoices in electronic form in GB** (if this is relevant in Germany) would require the authorisation of the competent local German tax office.

Recommendation

The regulatory changes described above could require extensive adjustments to the ERP system (adjustments to tax codes, the information shown on invoices and master data) as well as to organisational processes (e.g. dealing with the obligations to provide documentary evidence) and contracts with business partners (Incoterms). The businesses that are affected should prepare themselves as well as possible for the changes and, once Brexit has been accomplished, implement them quickly.

StBin [German tax consultant] Sabine Rössler

Loss carry-forward tied to the continuation of a business in accordance with Section 8d of the German Corporation Tax Act – Filing the application

Since the introduction of Section 8d of the German Corporation Tax Act *(Körperschaftsteuergesetz, KStG)*, losses that would have been derecognised in the event of a “harmful acquisition”, in accordance with Section 8c KStG, can now continue to be used. However, submitting the requisite application for the ascertainment of a loss carry-forward tied to the continuation of a business harbours a number of risks that are pointed out below.

1. Loss being derecognised

If no application is filed then the negative income that was available at the time of the harmful transfer of shares (loss carry-forward and the current losses until then) will be derecognised. When an application is filed, these and possibly other losses that have accumulated right up to the end of the assessment period will be included in the loss tied to the continuation of the business. The most recently ascertained loss tied to the continuation of a business can be derecognised if a harmful event occurs (e.g. discontinuation of business operations) if it is not covered by hidden reserves.

2. Filing the application

The application has to be filed for the first time for harmful share acquisitions in 2016 “in the tax return for an assessment for the tax assessment period in which the harmful share acquisition falls” (Section 8d(1) clause 5 KStG). An application that waives the formal requirements is not sufficient. The application has to be made in the tax return itself (in the appendix marked WA in the corporation tax return) and applies uniformly for corporation tax and trade tax.

3. Amendments to the application

It is disputed whether it is possible to make a request for the application of Section 8d KStG in the course of the assessment procedure or, e.g., retroactively within the scope of a tax audit. The revocation of an application is likewise unclear. Currently, the tax authorities refuse retroactively filed applications by issuing notices of rejection. By contrast, the Thuringian tax court deemed that a retroactive application could be filed (ruling from 5.10.2018, case reference: 1 K 348/189) because, from the law, it was not possible to ascertain a time limit for filing an application. The tax authorities have lodged an appeal against this (Federal Fiscal Court case reference: I R 40/18).

Recommendation

In any case, as of 2016, objections should be lodged against notices of rejection as well as notices of ascertainment of losses and corporation tax assessment notices that are related to this.

LEGAL

RAin [German lawyer] Katharina Stock

The social insurance payment obligation of a minority shareholder of a GmbH

A question that frequently arises in practice is whether or not a managing shareholder is subject to social insurance. Contractual details can be crucial for determining what the social security status actually is in an individual case. The Federal Social Court (Bundessozialgericht, BSG), in a recent ruling from 14.3.2018 (case reference: B 12 R 5/16 R), clarified that a minority shareholder of a GmbH (private limited company) basically pursues dependent employment and is therefore subject to social insurance. There are exceptions only within a very narrow scope.

1. Facts of the case and the procedural process

In the case in question, the claimant was a managing shareholder of a GmbH in which he held 12% of the share capital and, thus, acted as a minority shareholder. The German Federal Pension Scheme (Deutsche Rentenversicherung, DRV), in the course of a status ascertainment procedure that was initiated by the claimant, established that due to his employment the claimant was indeed obliged to pay into the German statutory pension scheme. The claimant took legal action against the respective assessment notices.

In the first instance, a social court refused the claimant's requests for the revocation of the DRV's assessment notices about his social insurance payment obligation. In the second instance, a higher social court likewise accepted the view of the DRV and dismissed the claimant's appeal. Even though the claimant was able to organise his working time for the GmbH freely and autonomously, in the light of the overall impression of the claimant's work it was the opinion of the courts that dependent employment should nevertheless be presumed. This was due in particular to the claimant's minority stake.

The claimant lodged an appeal and explained that he was able to freely engage in his activities in every respect and had not been integrated into the operating processes of the GmbH. Furthermore, he also bore the business risk so that there was no way that dependent employment existed and, consequently, no social insurance payment obligation either.

2. BSG – Scope of influence as the key criterion

The BSG dismissed the claimant's appeal as unfounded because he did not hold a blocking minority. The key criterion for independent employment and the exemption from the social insurance payment obligation that results from this is, primarily, the position as a majority shareholder. This is not the case where there is a stake of below 50% in the share capital. In the case of minority shareholders, it would only be possible not to presume that there is dependent employment if a "genuine" blocking minority had been expressly set out in the company agreement. As a result of this it would have to be possible for the managing minority shareholder to thwart the instructions and resolutions of the shareholders' meeting. By contrast, a "false" blocking minority that is restricted to particular issues is not appropriate for imparting the requisite legal authority. Possible prerogatives in the external relationship are irrelevant when assessing the social insurance payment obligation. The only thing that matters is the affected party's legal scope to influence the resolutions of the shareholders' meeting.

Recommendation

Please bear in mind that erroneous non-payment of social insurance contributions can entail late payment penalties, fines and, in the worst case, prison sentences. Legal certainty can only be created through a status ascertainment procedure.

RA/StB [German lawyer/tax consultant] Frank Moormann

The conditions for an effective exclusion of a shareholder

Sometimes, relations between the shareholders of a partnership or a corporation are so severely strained that the topic of forcibly excluding a shareholder has to be broached. However, company law puts high hurdles in place for such a drastic measure. In particular, exclusion has to be the last recourse and there must not be any more lenient options available for resolving the conflict. The Stuttgart court of appeals (Oberlandesgericht, OLG), in a more recent decision from 27.6.2018, once again set out in detail the requirements for an effective exclusion.

1. "Good cause" as a prerequisite

In principle, the exclusion of a shareholder is only possible if a justifying "good cause" is provided that would make continuing the business relationship unreasonable for the others. Such a cause could be seen to be in the person or the behaviour of the shareholder who is to be excluded, such as, in cases of gross breaches of duty (e.g. violations of competition law or breaches of the duty of loyalty), or other actions that harm the company. Several accusations that in their own right would not be sufficient could however justify an exclusion from an overall perspective.

Please note: It does not necessarily matter if there is culpability, nevertheless, within the scope of the overall assessment this should be taken into consideration. The same applies to the other concomitant circumstances, such as the period of involvement with the company, the behaviour to date or the contribution to the company.

2. Breakdown of relations

A profound rift between the shareholders, in conjunction with the destruction of trust, would only justify an exclusion if the shareholder who is to be excluded was the main cause of this situation and if there are not also reasons related to the other person that likewise justify an exclusion.

In the case in question, the OLG Stuttgart ruled in favour of these conditions. There, a (minority) shareholder had not accepted his dismissal as the managing director of a GmbH and had continued to act as the representative of the company. In the course of this, he had threatened the new management and had publicly denounced it, including, divulging internal company information about the economic situation. As it was not foreseeable that the shareholder would cease this behaviour that was damaging the company, the court approved the exclusion as a last resort. A prior warning was not necessary for this.

3. Avoid procedural errors

Furthermore, in order to exclude a shareholder (in this case through the redemption of shares), it is necessary to have a validly made shareholders' resolution. However, not every procedural error here will immediately result in the resolution being invalid. The OLG provided extensive feedback on the question of when an error would remain without consequences, lead to contestability, or result in the nullity of the resolution. It is possible to make the following basic statements.

» A procedural flaw would be inconsequential if, because of this, the membership rights of the shareholder concerned had not been adversely affected in a way that was relevant (e.g. despite the invitation not being in accordance with the rules the shareholder had nevertheless become aware off its contents in good time).
» Accordingly, a resolution may be contested if a relevant adverse effect had occurred as a result of the error (e.g. proper preparation was not possible because the invitation was late).

By contrast, a resolution would then only be invalid if there had been a particularly serious procedural flaw through which the shareholder's membership right had effectively been excluded. Ultimately, the shortcomings with respect to the invitation have to be tantamount to "no invitation" (e.g. an invitation via e-mail a few hours before the start of the meeting).

Recommendation

In view of the consequences of an exclusion resolution, careful preparation is advisable. We would recommend documenting not only the substantive requirements but also the compliance.

RA [German lawyer] Johannes Springorum

Brexit and the Ltd – The way out of the British legal form

Companies established in Germany in the legal form of a "private company limited by shares" (Ltd company) that will lose their freedom of establishment when the United Kingdom exits the European Union (Brexit) are to be given the possibility of transforming themselves into German commercial partnerships (with limited liability). To this end, the Fourth Amendment to the German Reorganisation Act *(Vierte Gesetz zur Änderung des Umwandlungsgesetzes, 4. UmwGÄndG)* came into force with effect from 1.1.2019.

1. Previous legal situation – Ltd company as a commercial partnership in the future ...

According to the settled case law of the Federal Court of Justice (Bundesgerichtshof, BGH), when the freedom of establishment ceases to apply, due to Brexit, the Ltd company will no longer be regarded as a corporation. In future, based on the so-called seat theory, a Ltd company will instead be treated either as an ordinary partnership *(offene Handelsgesellschaft, oHG)* if it operates a commercial enterprise, or otherwise as a company under German civil law *(Gesellschaft bürgerlichen Rechts, GbR)*. If the Ltd company has only one shareholder then it would be regarded as a sole proprietorship *(Einzelunternehmen)*.

Please note: According to the estimates of the Federal government in its draft of the legislation, this fate currently awaits approx. 8,000 – 10,000 Ltd companies that have their head offices in Germany. For their shareholders this means that they would lose the protection that they have had up to now of their liability being limited to the amount of the company assets and they would be

exposed to the risk of unlimited personal liability.

... and merger with a corporation

Up to now, Ltd companies were already able to merge across borders with German companies. There is a legal basis both in Germany (Section 122a et seq. of the Reorganisation Act (Umwandlungsgesetz, UmwG)) as well as in the United Kingdom (UK Companies [Cross-Border Mergers] Regulations 2007); under European law such ventures are likewise authorised (ECJ, judgement from 13.12.2005 – C-411/03SEVIC Systems AG). Although, up to now, only mergers with German corporations were possible (Section 122b(1) UmwG (old version)).

2. Changed legal situation – Merger with a partnership ...

The 4. UmwGÄndG now opens up the possibility for all European corporations (thus not restricted to those from the United Kingdom) of merging with German partnerships. The acquiring German legal entity can be a professional partnership (in the form of a German limited partnership, or KG, alternatively a German ordinary partnership, or oHG); however, it may not have more than 500 employees. This restriction is supposed to prevent co-determination, in accordance with the German One-Third Employee Participation Act, from being undermined (merger with a GmbH & Co. KG [a German limited partnership with a limited liability company as a general partner), which does not require co-determination, instead of with a GmbH].

Please note: In order to enable Ltd companies – which were frequently set up because of the low minimum capital requirements for this legal form – to be transformed into a German limited liability company form with low minimum capital, in the preamble to the Act the German legislator also expressly mentioned the UG *(haftungsbeschränkt)* & Co. KG [a combination of an enterprise company (with limited liability) and a limited commercial partnership].

... with simplification options and transitional arrangements

Generally, the provisions for a national merger of commercial partnerships should be applied to the merger procedure. In Germany, this also includes simplification options (e.g. waiver of merger report requirement) that were not contained in the reform of the underlying Directive relating to certain aspects of company law (DIRECTIVE [EU] 2017/1132 from 30.6.2017).

The 4. UmwGÄndG grants a two-year transitional period for cross-border mergers where, prior to Brexit, the merger plan had already been certified by a notary but had not yet been entered in the commercial register. During this period, the merger can still be registered as being cross-border with the commercial register court.

3. Tax implications

With respect to tax aspects, the merger of a Ltd company with a GmbH & Co. KG (or an UG [*haftungsbeschränkt*] & Co. KG) will be taxed in accordance with the provisions of Section 3 et seq. UmwStG. Upon application, the book values of a transferring corporation can be carried forward. The open reserves of the transferring corporations will be allocated proportionally to their shareholders, in accordance with their stakes in the nominal capital, as income from capital assets and a 25% deduction of capital gains tax will mean that, from a tax point of view, everything will generally have been covered.

Conclusion

National law only regulates the German side of a reorganisation. Nevertheless, the cross-border procedure in the context of a Ltd company will still be complicated and time-consuming. This is because, under the applicable UK Companies (Cross-Border Mergers) Regulations 2007, a pre-merger certificate and final approval of the cross-border merger have to be obtained from the High Court. This frequently involves cumbersome judicial proceedings and, currently, it is not yet foreseeable whether or not the British authorities will generally be willing to cooperate in the execution of mergers.

ACCOUNTING & FINANCE

StBin [German tax consultant] Sabine Rössler

Warranty provisions – seriousness with respect to use and adjusting events

The Federal Fiscal Court *(Bundesfinanzhof, BFH)* has clarified, once again, the requirements with regard to the creation of provisions for liabilities of uncertain timing or amount. In a recent ruling from 28.8.2018 (case reference: X B 48/18), the Court explained that a provision may not be created if a deficiency already exists on the balance sheet date but the use of such a provision by the obligated party could however not be seriously expected at that time because both parties to the agreement are not yet aware of the deficiency.

1. Provisions for liabilities of uncertain timing or amount

Liabilities can be uncertain in terms of the reason and/ or the amount. Provisions have to be created, in particular, for:

» an existing obligation to another party that is certain or probable,
» that arose for legal or economic reasons and
» provided that it is seriously expected that the provision will actually be used.

In its rulings, the BFH has already clarified, in many ways, the requirements with regard to the creation of provisions for liabilities of uncertain timing or amount.

2. Warranty obligations

Irrespective of the legal grounds on which a claim for compensation is based, thus whether the basis is legal or contractual, the crucial factor for the creation of warranty provisions is whether or not their use is mostly likely. This would imply that the obligee is aware of the circumstances on which a claim could be based. This would mean that, on the balance sheet date, complaints had already been made, or there was an expectation that complaints about deficiencies that had not yet been made would probably be put forward.

3. Principle of prudence

Following the principle of prudence, the conditions actually existing on the balance sheet date have to be assessed on the basis of a diligent businessperson's subjective knowledge level while drawing up the accounts within the deadline. Therefore, no new circumstances, occurring only after the balance sheet date, should be recognised in the financial statements. By contrast, adjusting events have to be taken into account; these are facts already objectively existing on the balance sheet date but that become known only subsequently (i.e. between the balance sheet date and the time when the accounts were being drawn up).

4. Adjusting events

From an adjusting-events perspective, complaints that have not yet been made as at the balance sheet date could justify the recognition of a provision. An objective starting point here would also be a deficiency for which no complaint has yet been received but for which recourse is expected. Within the scope of evaluating an individual case, an assessment has to be made as to whether or not an inherent shortcoming with regard to what was contractually specified and already existed but which, due to the client's operating procedures, had not yet become obvious ("had not yet occurred") and, therefore, no complaint could even have been made, appears to be sufficient when conducting an evaluation to be able to determine if this adjusting event is serious with respect to the assumption that the contractor will use the provision.

Conclusion

According to the BFH, the risk of the use of the provision by the contractor would then not predominate if both parties to the agreement were not yet aware of the deficiency as at the balance sheet date because on that date the deficiency would not yet have developed any adverse effect on the business and, therefore, would not have appeared to be at all discernible. In such a case no provisions for liabilities of uncertain timing or amount could be created.

StBin [German tax consultant] Sabine Rössler

No taxation of excess withdrawals in the case of contributions

The Federal Fiscal Court *(Bundesfinanzhof, BFH)* is of the view of that, in the case of a contribution of business assets into a corporation, withdrawals during the retroactive period could result in negative acquisition costs for the shareholding. This constitutes a rejection of the opinion of the tax authorities that taxation of the respective hidden reserves has to follow.

According to the regulations up to now, upon application, it has been possible to structure the contribution of business assets at book value into a corporation retroactively and to have the transfer cut-off date for tax purposes set at, for example, 31.12. The profits from the business operations in the retroactive period will be allocated to the acquiring corporation. Withdrawals and capital contributions for this period have to be allocated to the previous business owner (Section 20(5) clause 2 of the German Reorganisation Tax Act *(Umwandlungssteuergesetz, UmwStG)*). Moreover, according to Section 20(2) clause 2 no. 2 UmwStG, no negative business assets may be transferred. Therefore, in the opinion of the tax authorities, a withdrawal in the retroactive period that exceeds the contributed book value would result in the realisation of hidden reserves in the amount of the excess withdrawals (Subsection 20.19 of the 2011 German Reorganisation Tax Decree).

The BFH, in it ruling from 7.3.2018 (case reference: I R 12/16) was now of the opinion that the legal consequences of the excess withdrawals in the retroactive period would only occur subsequently. The sole aim of the provision relating to the allocation of withdrawals and capital contributions to the contributing business owner was merely to prevent the taxation of profit distributions. The owner's acquisition costs of the shareholding, in the form of the book values of the contributed business assets, would be carried forward via the value of the withdrawal or the contribution. No conditions have been provided for a "minimum recognition" of the contributed business assets. If, in the retroactive period, the balance of the capital contributions and withdrawals exceeds the contributed book values then, in the view of the BFH, negative acquisition costs will arise. When the shareholdings are sold this then will result in a corresponding disposal gain. Taxation of the hidden reserves contained in the shareholdings is thus ensured.

Please note: The BFH ruling was issued in relation to Section 20(7) UmwStG 2002. Nevertheless, it can be assumed that the ruling should also be applied to the current version of the UmwStG.

RAin [German lawyer] Sonja Blümel

(Non-)expiry of leave

The Federal Labour Court *(Bundesarbeitsgericht, BAG)*, in a recent ruling from 19.2.2019 (case reference: 9 AZR 541/15), decided what it was that employers have to do so that entitlement to leave can lapse if an employee does not take his/her leave voluntarily. The BAG had to adjudicate on this fundamental matter while giving due regard to the requirements in the ECJ's preliminary ruling in this case (case reference: C-684/16), which we reported on in the PKF Newsletter 01/2019.

According to the BAG, (minimum) leave only expires if employers have previously informed their employees (demonstrably) clearly and in good time about their specific entitlement to leave and the expiry periods and, moreover, if the employees concerned had nevertheless voluntarily not taken leave. Otherwise the leave would not lapse and would have to be compensated for on termination of the employment relationship.

Please note: In a case that has now been settled, a research scientist at the Max Planck Institute had sued for a gross amount of € 11,979.26 as compensation for 51 working days for which he had not applied for leave in 2012 and 2013. The state labour court, to which the case has now been referred back, now has to clarify whether or not the employer had complied with these obligations.

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AND FINALLY...

“The most dangerous world view is the world view of those who have never viewed the world.”

Alexander Freiherr (baron) von Humboldt (1769 – 1859), German natural scientist and founder of physical geography

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