PKF

Newsletter

Key Issue

Employee retention – Specific use of employment contract provisions

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PKF

Dear Readers,

In the last issue of our PKF Newsletter we were still assuming that the United Kingdom would leave the EU at the end of March and that here, in our April edition, we would have to present further consequences, especially in the area of customs. In actual fact, Brexit negotiations are going into extra time and we have now shelved these topics until greater clarity prevails. This has left room for reports on other important decisions by courts as well as pronouncements by the tax authorities that, largely from the point of view of the taxpayer, are encouraging.

In the first article in our Tax section, this initially concerns the issue of which expenses could include a notional amount of debt financing and, thus, could be eligible for a **trade tax add-back**. The tax authorities had shown themselves to be very creative here in recent times in the case of **trade fair costs**, however, they have now been shown the limits by a tax court. When determining the **interest expense on cash pooling that has to be added back**, the Federal Fiscal Court opted for this to be netted against interest income and, thus, it ruled in favour of the taxpayer. Following on from this is an article on the respective distinctions as to when add-backs have to be made and when not in the case of a subscription to **cloud services**. The ECJ has shown sympathy for **moving** from Germany to **Switzerland**. This has always held a certain appeal for those with large assets but was de facto frequently prevented. If an interest of more than 1% was held in a corporation then the hidden reserves had to be not only disclosed but also the tax on them had to be paid. This obstacle has now been eliminated through an ECJ judgement by placing Switzerland, a third country, exclusively on a level with moving within the EU/EEA and, therefore, no tax has to be paid in this respect. A report on **profit adjustments in accordance with Section 1 of the German Foreign Transaction Tax Act** that have likewise been limited by the ECJ rounds off our tax news section.

In the Legal section you will find, first of all, our Key Issue for this edition. Against the background of the growing skills shortage, we have highlighted courses of action with which it is possible to **tie employees**, through contractual arrangements, **to a company** in order, in this way, to be able to stem a potential exodus. This is followed by two articles on important supreme court rulings from the fields of company law and labour law that concern **executive liability** and **stumbling blocks relating to employment contracts.**

In the Accounting & Finance section, first of all, we discuss business expense deductions in the case of **contributions to provident funds** and, subsequently, we report on the topic of **blockchain**. You can read about how businesses can benefit from this new technology, for example, within the scope of the journal function in accounting.

With our best wishes for an interesting read,

Your Team at PKF

Key Issue

Employee retention – Specific use of employment contract provisions

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TAX

StBin [German tax consultant] Sabine Rössler

Trade tax add-backs I – Court ruling places limits in the case of trade fair costs and cash pooling interest

Trade tax add-backs are increasingly becoming a preoccupation in business practice. Fortunately, court rulings frequently place limits on fiscal interests, as was recently the case in a judgement on trade fair costs and the granting of loans within the framework of cash pooling.

1. Rental expenses in the context of trade fair costs

According to a ruling of the Düsseldorf tax court, (from 29.1.2019, case reference: 10 K 2717/17), a manufacturing enterprise that incurs rental expenses as part of trade fair costs may only add these back for trade tax purposes if the rented space belongs to the company's (notional) fixed assets. Items that are considered to be notional fixed assets are those that are used in the business but are not intended for consumption. Assets are assigned to the categories here on the basis of the purpose for which they were designated by the business operator. If the business purpose requires the permanent availability of an asset then a notional fixed asset may be deemed to exist. This also applies if the asset is used for a short term of a few days or hours.

The tax court was of the view that the object of a manufacturing enterprise does not necessarily require it to take part in trade fairs constantly and, therefore, to have trade fair stand spaces available in its business on a permanent basis. In fact, an enterprise has to make a new free choice at least every couple of years as to whether or not it should take part in a trade fair. Not taking part would not have a significant negative impact on the commercial activity of the business operator.

In their reasoning, the Düsseldorf-based judges made a distinction between a manufacturing enterprise and concert organisers who have to rely on appropriate facilities to realise their business purpose (cf. the Federal Fiscal Court ruling from 8.12.2016, case reference IV R 24/11, in this regard). For a manufacturing enterprise, renting space on a trade fair stand can rather be compared with hotel rooms, which normally do not result in notional fixed assets being created either. Therefore, trade tax add-

backs for external immovable capital assets pursuant to Section 8 no. 1e of the German Trade Tax Act (Gewerbesteuergesetz, GewStG) do not apply.

Please note: The ruling was issued in relation to trade fair stand rental and immovable capital assets. The courts have not yet clarified whether or not the principles from the ruling of the tax court would also apply to movable capital assets connected to a trade fair (e.g. office furniture and kitchen furnishings). As the tax court has permitted an appeal against this ruling further developments remain to be seen.

Recommendation

In all cases that are still open, it would thus be advisable to lodge an objection to trade tax add-backs of trade fair costs for immovable and movable capital assets. Even though the tax court ruling was issued solely in relation to trade fair stand rental it should nevertheless apply by analogy for add-backs for furniture costs at trade fairs in accordance with Section 8 no. 1d GewStG.

2. Cash pooling – Add-backs limited to the net interest amount

The Federal Fiscal Court (Bundesfinanzhof, BFH), in its ruling from 11.10.2018 (case reference: III R 37/17), expressed its opinion on the conditions under which debit interest and credit interest, which arises from reciprocal loans that have been granted within a cash pool, could be netted for trade tax add-backs.

In the opinion of the BFH, there is a generally applicable prohibition on netting, according to which neither several contractual obligations may be combined nor can netting be allowed. Although, according to the BFH, it is possible to make an assessment that there is a single loan relationship if the reciprocal loans issued between two bodies are similar, serve the same intended purpose and are actually routinely netted against each other.

In the case in question, the loans – even though they were issued in different currencies – were thus similar because they were granted with identical rates of interest and were subject to the same contract conditions. The joint purpose of the loans was the optimisation of interest rates and financing. The actual netting of the loans was shown in the presentation of the accounting transactions.

The BFH found that it was possible to net against each other, every bank working day, all the accounts included in the cash pool. The resulting balance had to be carried forward. The BFH concluded that, under these conditions, only a debit balance that subsequently arises at the taxpayer's expense in accordance with Section 8 no. 1(a) clause 1 GewStG should be added back.

StBin [German tax consultant] Sabine Rössler

Trade tax add-backs II – Charges for cloud services

Cloud services or cloud computing are understood to mean services where a company uses one or more of a provider's IT applications from the cloud. Such services frequently replace the traditional purchase of a licence. According to Section 8 of the German Trade Tax Act *(Gewerbesteuergesetz GewStG)*, the costs for cloud services should potentially be added back when calculating the trading profit. It is therefore necessary to make a distinction from other services.

1. Differentiation of typical cloud services

A cloud contract generally regulates a large number of services. If possible, the services that are agreed should be differentiated in order to enable a separate assessment for trade tax purposes. The cloud services that are normally provided are performed over a – usually flexible – longer period of time.

- **SaaS** – In the case of SaaS (Software as a Service) companies are enabled to use software over the internet. The software is not installed directly with the users but instead operated on the provider's server.
- **PaaS** – Platform as a Service, or PaaS, is understood to mean a development platform on which users can

develop their own applications. For this purpose, a software environment is provided over the internet to companies.

» **IaaS** – Infrastructure as a Service, or IaaS, denotes the use of storage space and computing power in the cloud. In this case, companies have direct access to computing instances and thus the provider's IT infrastructure.

2. Classification for trade tax purposes

(1) SaaS – Under Section 8 no.1(f) clause 1 GewStG this type of service should be added back for trade tax purposes as a cost for a time-limited provision for use. The provision of software in this way includes, e.g., legal aspects of licensing to the extent that the software can be streamed from the provider to the customer. Storage then occurs in the customer's main memory and, for a limited period, the customer undertakes an act of duplication that is relevant under copyright law.

(2) Charges for providing **PaaS** are also normally rather allocated to user fees. What ultimately would matter here would be the specific contract conditions (in particular, with respect to the term and how the charges are calculated).

(3) IaaS (such as, e.g. support) however constitutes the provision of services and is generally not relevant for trade tax add-backs.

3. One alternative is a rental agreement

Another court decision that should be noted is one made by the German Federal Court of Justice where providing application software (within the scope of a "SAP contract") was held to constitute a rental agreement (ruling from 15.11.2006, case reference: XII ZR 120/04). A rental contract does not involve any transfer of rights. Accordingly, the provision of software solutions can be the object of a rental contract and pursuant to Section 8 no. 1(d) GewStG would be added back.

Recommendation

The emerging developments presented above have to be examined in accordance with the specific contractual arrangements. Please do not hesitate to contact us if you require the support of PKF's experts in an individual case analysis with respect to the question of whether or not trade tax add-backs should be made.

WP/StB [German public auditor/ tax consultant] Daniel Scheffbuch

Exit taxation – ECJ ruling simplifies changing domicile to Switzerland

If a German domicile is given up or habitual residence in Germany is terminated then the unlimited tax liability status in Germany also comes to an end. However, hidden reserves could be disclosed and subsequently taxed. In this respect, the ECJ recently gave the all-clear for moves to Switzerland.

1. General information on exit tax

If there has been an unlimited tax liability status in Germany for at least 10 years prior to the move then, upon departure, the hidden reserves in holdings of at least one per cent in corporations in Germany will be taxed as business income. The difference between the current value and the acquisition costs thus has to be taxed even if the gains have not yet been realised and accrued. This tax liability generally becomes due and payable immediately when the unlimited tax liability status ends.

In order not to interfere with free movement rights within the European Union and the European Economic Area (EEA), and in order to avoid unlawful discrimination, Section 6(5) of the Foreign Transaction Tax Act (Außensteuergesetz, AStG) accords privileges to nationals of EEA member states when they move to a different EEA member state by deferring the tax liability without interest and without the provision of a bank guarantee. Up to now, when moving to Switzerland – which is not part of the EEA but only the European Free Trade Area (EFTA) – a tax deferment without interest has not been possible. The only option available was to pay the exit tax that became due in instalments over a maximum period of five years.

2. The ECJ judgement with respect to Switzerland

In this connection, the ECJ recently decided that, in the case of a move to Switzerland, not granting this privileged tax deferment conflicts with the provisions in the Agreement on the Free Movement of Persons (AFMP) between the Swiss Confederation and the EU (judgement from 26.2.2019, case: C-581/17, "M. Wächtler/FA Konstanz"). In the opinion of the ECJ, this agreement has a level of protection that is similar to Community law.

Such a ruling was expected; in the initial proceedings, the Baden-Wuerttemberg tax court had already raised considerable misgivings with respect to exit tax.

Please note: Nevertheless, the judgement is only applicable to Switzerland, in the case of all other third countries the exit tax rules will remain in force.

Recommendation

It is recommended that all taxpayers who have moved to Switzerland and for whom notional disposal gains have been assessed in their income tax assessment notices and the tax on those gains has not been deferred without interest should hold their assessment notices open and lodge an objection. For all those taxpayers for whom, up to now, this tax alone has acted as a barrier to relocating – this obstacle has now been eliminated.

WP/StB [German public auditor/ tax consultant] Dr Dietrich Jacobs

Profit adjustments in accordance with Section 1 of the German Foreign Transaction Tax Act

The German Federal Ministry of Finance applies the ECJ's "Hornbach ruling" solely to restructuring cases in the EU

In accordance with Section 1 of the Foreign Transaction Tax Act (*Außensteuergesetz, AStG*), income can be revised up if domestic (German) taxpayers reduce their income in Germany via agreements with entities abroad that do not comply with the arm's length principle. The Federal Ministry of Finance (*Bundesministerium der Finanzen, BMF*) has now responded to an ECJ judgement that is relevant in this respect.

1. Hornbach ruling on profit adjustments in accordance with Section 1 AStG

The ECJ decided, in May 2018, in its so-called "Hornbach ruling" that a profit adjustment in accordance with Section 1 AStG would only be compatible with the freedom of establishment under European law if an opportunity remained for the German taxpayer to present evidence of a commercial justification for the non-arm's-length terms where that justification arises from the taxpayer's position as a shareholder (cf. also PKF Newsletter 10/2018).

2. The BMF's application principles

The BMF has now expressed its view, in administrative guidance, on the application of the principles of the Hornbach ruling. According to this, the following applies.

- It has to be assumed that there is a requirement for a restructuring-induced measure that has to avert overindebtedness or imminent illiquidity and ensure the continued existence of a closely related party and/ or groups of companies. The taxpayer has to provide proof of such a requirement including the need and ability to restructure.
- The BMF rejected the application of the principles of the ruling to cases outside of the EU (so-called "cases that involve third countries").

On the one hand, the above-mentioned BMF circular (which is from 6.12.2018 and can be downloaded at www.bundesfinanzministerium.de) will ensure practical application certainty for now. On the other hand, the BMF has made a very restrictive pronouncement. If the above-mentioned conditions are not satisfied then, currently, a clarification could potentially only be expected before a court.

Recommendation

Taxpayers who wish to invoke the BMF circular should now pay particular attention to presenting evidence of the need for a restructuring-induced measure.

LEGAL

RAin [German lawyer] Yvonne Sinram

Employee retention – Specific use of employment contract provisions

Against the background of the skills shortage, the long-term retention of experienced employees in companies will become increasingly important. For this purpose, in principle, employers have a variety of options at their disposal in order to enhance the attractiveness of the company for employees. This report highlights selected legal courses of action for companies in order to prevent or impede an employee exodus.

1. Longer notice periods

If a company is not covered by a collective agreement then an employee and an employer can mutually agree notice periods that are longer than those provided for under the law. It would accordingly even be possible to agree a notice period of up to five-and-a-half years without this being classed, from the outset, as unconscionable or an

inadmissible restriction of the freedom of occupation (Section 12 of the Basic Law). It is important for the process for extending the notice period to be clearly regulated and to permit no leeway for interpretation in order to satisfy the transparency requirements of the law pertaining to general terms and conditions, which is generally applicable.

The advantages of agreeing a longer notice period lie in longer term predictability as well as more time to find a suitable successor to an outgoing employee.

By contrast, there could be a detrimental impact if an employee does indeed decide to give notice but still 'has to' stay in his/her old job for a longer period. In such cases, it is to be feared that the motivation and performance of a large number of employees would dwindle significantly ('work-to-rule'). Moreover, long notice periods would naturally impose a considerable constraint on an employer's own freedom to do business, e.g., if it ultimately turned out that an employee did not provide the boost that was assumed when the employment contract was concluded.

2. Post-contractual non-compete clause

In a regular employment relationship, on account of the duty of loyalty, employees are prohibited from entering into competition with their employers. Furthermore, an employer and employee can mutually enter into a competition agreement, in the employment contract or in an addendum to it, through which the employee undertakes to refrain from competing, even after the employment contract has been terminated, for a maximum period of two years. This constitutes a not inconsiderable interference with the basic right of freedom to practise an occupation; that is why the requirements for post-contractual non-compete clauses in terms of their contents are accordingly high. In particular, employees always also have to be granted an entitlement to so-called 'compensation for adhering to a non-compete clause'. A non-compete clause without an agreement on compensation for adhering to it would be invalid. The compensation that is agreed and that will be paid has to be, for the duration of the ban, at least half of the amount of the last contractually agreed payments received by the employee. If, prior to the termination of the employment relationship, it transpires that the competition risks are lower than expected then the employer can unilaterally waive the non-compete clause. However, the employer would then still be obliged to pay compensation for adhering to a non-compete clause for another year from the date of the waiver without the employee having to comply with the ban.

3. Agreement of cut-off date clauses

Employers have the option of making bonus payments, which are not of a remunerative nature, dependent on the continued existence of the employment relationship on a particular cut-off date. A Christmas bonus that is linked to the continued existence of the employment relationship and is not intended as remuneration for work that has been performed can be made conditional on an unterminated employment relationship on the payment

date. Entitlement to a bonus payment, which is not of a remunerative nature, would then cease altogether if the employee were to leave before the payment was due or before the agreed cut-off date. By contrast, bonus payments that are determined in target agreements cannot be made dependent on the continued existence of the employment relationship on a particular cut-off date owing to their remunerative nature.

4. Agreement of repayment obligations

Another effective instrument for employee retention is the assumption of the vocational and advanced training costs for an employee. In order to ensure that the employee remains in the company for a certain period of time once the advanced training has been completed the employer and employee should conclude a written advanced training agreement that includes a repayment clause. Such so-called repayment clauses would be subject to an exhaustive GTC check. Against this backdrop, the following should be taken into account.

- The consequences that would arise for an employee when such an advanced training agreement has been concluded have to be pointed out to him or her unambiguously and clearly right from the beginning of the advanced training that has been agreed.
- The greater the benefit to an employee from advanced training, the more likely it is that s/he will be expected to share some of the costs.
- When determining the duration of the permissible binding of an employee, after the completion of advanced training, what matters is the scope of the advanced training programme as well as the amount that has to be repaid and the settlement of this.

If remuneration continues to be paid during a training course that lasts no longer than one month then binding the employee for a period of up to six months would be permissible. By contrast, in the case of an advanced training programme that lasts for more than two years, without any performance on the job, it would be possible to bind the employee for a period of five years. If the repayment clause were to exceed the appropriate binding period as agreed in the general terms of business then it would be completely unenforceable. Another important point is the pro rata reduction in the refundable amount the longer the employee is on the payroll of the employer. An inappropriate pro rata erosion of the amount that has to be repaid by satisfying the deadline parts of the binding period would make the repayment agreement completely unenforceable.

A repayment clause would moreover be unenforceable if the advanced training was solely in the interests of the employer and did not enhance the employee's prospects in the labour market. In such a case, cost sharing by the employee would be excluded.

Recommendation

As the possible courses of action outlined above reveal there are various options with respect to employment contract arrangements for tying employees to a company. However, due to the legal pitfalls that these frequently involve you should seek expert advice.

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

Requirements for the allocation of responsibilities among a management team

The larger a company, the greater the need normally for a division of responsibilities at management level, too. Here, the principle of "overall responsibility" of the management function clashes with the operational requirements of an efficient management organisation. In a landmark decision, the Federal Court of Justice (Bundesgerichtshof, BGH) has now clarified the requirements that have to be placed on an effective allocation of responsibilities and/or business and that would enable an individual, in a liability case, to rebut accusations that s/he had been at fault (ruling from 8.11.2018, case reference: VIII ZR 11/17).

The case involved a typical situation. A managing director who was not responsible for the commercial department was held liable for payments made after factual insolvency had occurred.

1. Clear and unambiguous delimitation

The organisation of business management functions is

part of corporate management and every person who is put in charge of an area has to fulfil his/her obligations with the due care of a prudent businessperson. In the case of the allocation of responsibilities, each member of the management team has an obligation to assure him/herself that

- the allocation includes the performance of all possible business management functions,
- the function responsibilities have been clearly and unambiguously allocated,
- the responsible individuals are in each case technically and personally qualified,
- the allocation of responsibilities has the consensual support of all the managing directors and
- the responsibility of the overall management body for non-delegable matters has been maintained.

2. Formal requirements

Somewhat surprisingly, the BGH decided that the allocation of responsibilities does not have to be agreed either in writing or expressly. Therefore, in theory, an allocation that is made verbally or by tacit agreement would be adequate. However, in view of the stringent material requirements and the obligation of an individual to provide evidence it will de facto not be possible to dispense with an explicit written allocation of responsibilities.

If the articles of association do not contain any pertinent provisions, and if the shareholders do not approve rules of procedure either, then the management team can provide such rules for itself. According to prevailing opinion, the right of management to organise its own affairs would cover this.

3. Monitoring and oversight duties

Even if there is an effective allocation of functions, nevertheless, the responsibility for overseeing the work lies with each member of the management team. In this respect, each member is entitled to information about matters outside his/her sphere of responsibility from the individual who is in charge. Moreover, the latter is obliged to voluntarily report on all the important developments in his/her department.

However, it is not always possible to determine a specific number of checks and this will depend on the particular circumstances. Strict criteria generally apply to the filing for insolvency proceedings in good time. For example, in the case in question, the managing director who was not responsible for the commercial department should have concerned himself with the company's financial and economic situation by making specific enquiries during the course of the year. Moreover, he should then have compared the respective information from the responsible managing director with the financial framework for the business.

Recommendation

In a multi-headed executive committee with different competencies it would thus, in any case, be advisable to adopt written rules of procedure that satisfy the requirements of court rulings. Furthermore, individuals should sufficiently document the fulfilment of their remaining supervisory duties.

RA [German lawyer] Frederic Schneider

Revocation of severance agreements if the requirement of fairness in negotiations has been disregarded

An employee is not able to revoke a severance agreement through which her employment relationship ends even if it was concluded in her private dwelling. However, a severance agreement can be unenforceable if it has been reached in disregard of the requirement of fairness in negotiations.

1. Contesting and revoking a severance agreement

In the underlying case, the claimant was employed by the defendant as a cleaner. The claimant concluded a severance agreement, in her private dwelling, with the defendant employer's life partner. This agreement included the immediate termination of the employment relationship without any financial settlement being paid. The reason for the agreement negotiations and their sequence were disputed. According to the account given by the claimant, she was ill on the day the severance agreement was signed. Furthermore, she contested the severance agreement on account of an error, wilful deceit and unlawful threats and revoked it by way of precaution. In her action, the claimant was striving, among other things, for the termination of the employment relationship through the severance agreement to be disallowed. In the course of the proceedings, the claim was initially dismissed by the competent district court. Subsequently, the VIth Senate of the Federal Labour Court *(Bundesarbeitsgericht, BAG),* in its ruling from 7.2.2019 (case reference: 6 AZR 75/18) quashed this decision and referred the case back to the competent district court for negotiations.

2. A reason for contestation in the case of a revocation of an employment contract

In the proceedings that reached the BAG, the employee making the claim had based the reason for contesting the revocation of the employment contract on Section 312(1) in conjunction with Section 312g of the Civil Code *(Bürgerliches Gesetzbuch, BGB)*. This grants consumers the right of revocation, in accordance with Section 355 BGB, for contracts negotiated away from business premises. In principle, employees are also consumers, however, agreements that terminate employment relationships do not to fall within the scope of Section 312 et seq. BGB. Accordingly, the interim conclusion of the BAG was that the claimant had not brought forward a reason for contestation that could justify the revocation of the termination of the employment contract.

3. Fairness in negotiations as an accessory obligation in an employment contract

Nevertheless, the judges at the BAG criticised the fact that, so far, the district court had not checked to see if the requirement of fairness in negotiations had been complied with prior to the conclusion of the severance agreement. This is an accessory obligation in an employment contract that would be disregarded if one side were to create a situation where there is psychological pressure that would make it significantly more difficult for the contracting party to make a free and considered decision about concluding a severance agreement.

In the underlying case, according to the BAG, this could be seen, in particular, in the employee's weakness due to illness and the deliberate exploitation of this situation by the defendant. This would have resulted in putting the claimant in such a position as if she had not concluded the severance agreement; the employment relationship would have continued to exist.

Outlook

In view of the fact that the case has been referred back, the district court will have to reassess the enforceability of the severance agreement. If the requirement of fairness in negotiations had been disregarded then the defendant employer would have to pay compensation.

WP/StB [German public auditor/ tax consultant] Dr. Matthias Heinrich/ Julia Hellwig

Reduction in business expenses in the case of contributions to provident funds

Contributions to provident funds may be deducted for tax purposes as business expenses, on the balance sheet date, up to an amount of 75% of so-called active emoluments (remuneration). Yet, the dynamisation of pension benefits or deferred benefits can be agreed for a specific structure of a provident fund commitment and this would result in the possibility of higher contributions. However, there are limits.

1. Over-provisioning in the opinion of the tax authorities

If a pension commitment is made on the basis of dynamisation and if this together with the statutory pension is above the 75% limit then, in the opinion of the tax authorities, this is deemed to be over-provisioning; this leads to a pro rata reduction in the business expenses. This is because there is then an above average pension commitment that anticipates assumed future income and salary developments. This is contrary to the cut-off date principle according to which such trends may not be taken into account.

2. The limits set by the Federal Fiscal Court

The Federal Fiscal Court (Bundesfinanzhof, BFH), in its ruling from 31.7.2018 (case reference: VIII R 6/15), clarified that, in an examination of over-provisioning, the dynamisation of pension benefits or deferred benefits is not always inconsequential. In fact, an annual growth rate of above 3% can be substantial in an examination of over-provisioning and particularly if the pension commitment, without taking into account the dynamisation, is already significantly above – or also merely on the threshold of – 75%. The fixed percentage increases then constitute an additional compensation for future rising income trends and cannot be unrestrictedly recognised because otherwise the over-provisioning limit could be moved upwards indefinitely.

Philipp Steinau / WP [German public auditor] Thorsten Preisegger

Blockchain – A new technology that is helping companies

All too often the public perception of the new blockchain technology is confined solely to its first and best-known application, namely, the cryptocurrency Bitcoin. We already discussed Bitcoins in detail in the PKF Newsletter 4/2018. However, the use of blockchains is in no way limited to the Bitcoin currency, but it is also suitable for many documentation processes such as, for example, the journal function in accounting.

1. What is a blockchain anyway?

A blockchain is a database available on multiple systems. Here, the information is stored in a chain of successive blocks. In each case, besides the newly saved information, among other things, every block contains a checksum, the so-called hash value, that references the data collected previously in this blockchain. A significant advantage of a blockchain arises from this linking, namely, that all the users who access it will always have the same current status as a copy and store it in a decentralised way. As a result, blocks added to the blockchain by a user are confirmed by other users and embedded.

The decentralised and encrypted storage that precisely records every change means that the transactions are virtually tamper proof. The authenticity of the transactions is ensured by a consensus mechanism within the network. The individual transactions can be completely transparently verified and, thus, digital identities as well as ownership rights can be determined clearly and with legal certainty.

2. Application areas for a blockchain

A block chain can be applied wherever information is supposed to be exchanged or stored in a tamper-proof way. A blockchain is thus generally suitable, in particular, for the traditional journal function in accounting. Applying it to proof of origin and the distribution channels for goods in logistics and trade would be another obvious area. In the case of pharmaceutical products or animal products as well as classic import products, such as tobacco, extensive documentation has to be maintained about their origins and delivery channels. All this information could be documented in a blockchain, starting from the producer, including the hauliers or importers and right up to the retailers. The documents would then be available at all times, e.g., for health and veterinary inspection offices or customs.

Example: There is already such a documentation practice in diamond trading. For example, identifiers for diamonds extracted from South African mines, such as colour, size and certificate number, are stored in a blockchain. Furthermore, it is possible to record the distribution chain right up to the retailer. The high degree of transparency efficiently impedes the distribution of stolen or conflict diamonds.

3. Smart contracts

It is also possible to realise self-executing contracts, so-called smart contracts, via a blockchain. Yet, the term is initially misleading because smart contracts are not agreements in the legal sense but rather the implementation by a computer program of already existing written agreements.

To this end, upon the occurrence of previously defined conditions, particular actions are automatically performed. Thus, for example, payment for a delivery could be automatically triggered if, during the incoming goods inspection, the delivery of the ordered quantity is confirmed. All the information from the order by the customer, including the processing by the supplier and the forwarding agent, right up to incoming goods inspection and the receipt of the payment would be stored here in the blockchain.

4. Blockchain and data security

One of the essential foundations of a blockchain is the creation of transparency among the users. Nevertheless, blockchain technology can also be employed in relation to confidential contents. For example, a supplier could set up a private blockchain with its customers and document in it all the price information, orders, deliveries and payments. In order to prevent tampering, despite the low number of users at the moment, a hash value for the private blockchain would be generated at regular intervals and stored in a public blockchain. By subsequently comparing the values stored in the public blockchain with the hash values generated in the private blockchain it would be possible to demonstrate to individuals who previously had no access to the private blockchain that it has not been modified retroactively.

Recommendation

By implementing systems based on private blockchains it would be possible to safeguard existing business relationships in the long term because the investments in the corresponding reorganisation of business processes would result in more secure and more efficient procedures.

5. Conclusion

Applications based on blockchain technology are currently still at an early stage of development and a little imagination is still necessary in order to identify the existing potentials. Although, the current state of this technology is widely being compared with the first steps in the field of e-commerce. When redesigning business processes, it would thus be worth now already focusing firmly on blockchain technology. Even the German government is currently engaging with this topic and will present its blockchain strategy in summer 2019. We are monitoring this technology with respect to its potential practical applications, in particular, and would be pleased to discuss with you its implementation in your company.

StBin [German tax consultant] Sabine Rössler

No withholding tax on online advertising

Online marketing expenses, to some extent, have become a particular focus of tax audits. From the point of view of the tax authorities, advertising services from foreign providers (e.g. from Google to domestic (German) companies) could accordingly constitute an "assignment of advertising rights" for which the advertiser would be obliged to withhold tax at the source and forward it in accordance with Section 50a of the German Income Tax Act *(Einkommenssteuergesetz, EStG)*. A tax liability for a provider of online advertising services in Germany is usually ruled out because the provider does not have a permanent establishment in Germany. If the foreign provider assigns the domestic (German) customer a right to use together with the advertising service then the provider generates so-called floating income from business activities. In order to ensure that this domestic (German) income is taxed it would be necessary for the customer to withhold tax at source.

However, the all-clear has now come from the German federal and state governments. According to them, there is no such obligation to deduct tax at source.

Please note: In a press release from 14.3.2019, the Bavarian State Ministry of Finance clarified that there would be "No tax deduction for online advertising". Domestic companies should be spared unnecessary additional tax burdens in connection with online advertising.

WP/StB [German public auditor/ tax consultant] Dr. Matthias Heinrich/ Julia Hellwig

BMF alleviates the strict requirements of the affiliation privilege for trade tax purposes

The ECJ decided that the affiliation privilege for trade tax purposes violates the principle of the free movement of capital under Article 63 et seq. TFEU as this provision provides for more stringent requirements than Section 9 no. 2a of the Trade Tax Act *(Gewerbesteuergesetz, GewStG)* with respect to domestic (German) dividends (cf. PKF Newsletter 11/2018). The tax authorities have now responded to the above-mentioned ECJ judgement with the identical decrees of the federal states, from 25.1.2019. According to these, Section 9 no.7 GewStG shall be applied to third country situations subject to the following provisons.

» The minimum shareholding of 15% in the subsidiary company has to exist at the start of the tax assessment period if the pre-condition that the shareholding has to have existed without interruption since the start of the tax assessment period excludes a reduction.
» The activity requirement clause no longer has to be satisfied.
» The particular pre-conditions for profits from second-tier subsidiaries that are received via a subsidiary company shall no longer be applicable.

Please note: The principles of the decrees shall pertain to all open cases and until the application of a new legal provision for Section 9 no.7 GewStG.

WP/StB [German public auditor/ tax consultant] Martin Wulf

Increased tax-free allowance for tributes for members of clubs

The Baden-Wuerttemberg Ministry of Finance has increased the tax-free allowance to € 60, retroactively to 1.1.2019, for tributes for members of clubs. Clubs in Baden-Wuerttemberg had been hitherto allowed to spend a maximum of € 40 on a tribute for a member. The aim of raising the non-objection limit is to strengthen volunteering engagement and to reduce the bureaucratic burdens for clubs.

Please note: Each federal state individually manages the non-objection limit. For example, the Bavarian Finance Ministry has not fixed a tax-free allowance but has generally stated that "tribute amounts that are appropriate and customary" are permissible.

PKF

AND FINALLY...

"Europe does not grow out of treaties, it grows from the hearts of its citizens or it does not grow at all."

Klaus Kinkel, 17.12.1936 – 4.3.2019, lawyer and German politician,
Foreign Minister 1992 – 1998

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