PKF

Newsletter

Key Issue:
Liquidity management –
Generating cash effects through
order-to-cash processes

09|20

Dear Readers,

Numerous tax law changes to help overcome the coronavirus crisis were only recently passed in June. Companies and consultants are still busily implementing these, in particular, in respect of the reduced VAT rates. Yet, the lawmakers have already put forward the **draft bill for the German Annual Tax Act 2020**. In our first report in the Tax section, we have put together the most important key points on income tax.

In our second contribution we have addressed an issue that could be interesting in the context of accelerated inheritance - if a **gift is made under reservation of usufruct** and the asset that is gifted is intended to be sold then the parties will usually wish to surrender the usufruct. The **benefactor waiving usufruct** can then be granted a substitute, a so-called **surrogate**. In this issue of our newsletter we present gifting under reservation of usufruct. In our next edition we will work through the effect of a waiver and the granting of a surrogate.

Our third tax-related article is about **consolidated tax groups** for profit tax purposes where we discuss the issue of whether or not there can potentially be **profit transfers** prior to tax consolidation and even **apart from tax consolidation** in addition to regular transfers and, moreover, what consequences would arise in such a case for this, at any rate, complex instrument.

We kick off the Legal section with an update on an issue that we dealt with in the last edition of our newsletter, namely, **business closure insurance cover**. This is followed by an article on the consequences of **Brexit** for **UK limited companies** that have administrative headquarters in Germany. A very urgent need for action has arisen here as a result of the conflict between **British 'incorporation' theory and German 'real seat' theory** that, in the absence of counter measures, will lead to a **loss of the limitation on liability**.

Our Top Issue in this edition can be found in the Accounting & Finance section. There we discuss the advantages that can arise for liquidity management - so important in these coronavirus times - when **statistical methods are integrated into order-to-cash processes**. In particular, the processes can be automated with the result that it is possible to reduce the consumption of resources and prepare a fact-based liquidity forecast.

We continue our series of impressions to provide inspiration for a holiday destination in Germany with the regions of Mecklenburg-Western Pomerania and Brandenburg.

We hope that you find the information in this newsletter interesting.

Your Team at PKF

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Key Issue

Liquidity management – Generating cash effects through order-to-cash processes

Contents

TAX

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

Planned tax changes – Draft bill for the German Annual Tax Act 2020

The draft bill for the German Annual Tax Act 2020 was published during the summer break. It is likely to be a while before the legislation is passed and, moreover, various amendments can be expected. Nevertheless, at this juncture, in the following section we would like to present a selection of the most important income tax measures because these could give rise to tax planning considerations now already.

1. Investment allowance

While, up to now, the investment allowance *(Investitionsabzugsbetrag,* so-called IAB) only applied to those assets that were used 90% in business operations in the year when the investment was made and in the subsequent year, in the future, this limit will be lowered to 50%. At the same time, the plan is to increase the IAB from 40% to 50% of the anticipated acquisition/production costs and to determine the value limit up to which a business can claim the IAB uniformly and solely with reference to profit calculated in accordance with Section 4 or Section 5 of the Income Tax Act (Einkommenssteuergesetz, EStG) up to a maximum of €125k. However, tightening is envisaged in two areas:

» Once an initial tax assessment or initial separate assessment has become non-appealable an application for an IAB will be permitted only if, at the time the IAB is claimed, the asset that is to receive the tax credit has not yet been acquired or produced.

» The Federal Fiscal Court *[Bundesfinanzhof, BFH]* had ruled that an IAB that has been set up in the joint ownership sphere of a business partnership could also "be used" for an investment by a co-partner in special business assets. In the future, as a reflection of the intention of "non-application legislation, an IAB at the level of joint ownership would only be used for jointly

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owned investments and an IAB in special business assets only for investments made by a co-partner or his/her legal successor.

The above-mentioned amendments would apply for the first time to an IAB in a financial year starting after 31.12.2019; however, the tighter rules would be taken into account for financial years starting after 31.12.2020.

2. Benefits provided by employers "in addition to the remuneration due in any case to employees"

Various benefits offered by employers, such as subsidies for travelling on scheduled public transport services, for the transfer of ownership of company bicycles, childcare allowances, etc., enjoy income tax breaks if they are provided "in addition to the remuneration due in any case to employees". In the view of the BFH, it is also possible for cases of salary waiver/conversion to satisfy this requirement; nevertheless, the fiscal authority does not apply the underlying ruling. Now, the aim is to introduce a legal definition, which would take effect for the first time for remuneration payment periods ending after 31.12.2019, where in cases of salary waiver/conversion it would no longer be assumed that these are benefits provided in addition to the remuneration due in any case to employees.

3. Making available housing at a reduced price

Up to now, in cases where a rent level is less than 66% of the average market rent for the local area the rental has been divided up into remunerated and non-remunerated portions and, as result, it was only possible to deduct the allowable expenses from the remunerated portion. However, as of 2021, a tiered system will (once again) apply:

- In the case of rent that is below 50% of the average level for comparable dwellings in the area then the provision for use has to be divided up into remunerated and non-remunerated portions.
- In the case of rent that is at least 50%, but below 66% of the average level for comparable dwellings in the area then a total surplus forecast has to be made. If this turns out to be positive then it would be possible to deduct the full amount of allowable expenses, by contrast, in the event of a negative result the deduction could only be made only in relation to the remunerated portion.
- In the case of rent that is at least 66% of the average level for comparable dwellings in the area, under the EStG, as previously, the full amount of allowable expenses will be deductible.

Recommendation

The envisaged changes to both the IAB as well as the benefits provided by employers "in addition to the remuneration due in any case to employees" will (at least to a certain degree) already have an effect in 2020. Therefore, you should consider the extent to which, by being proactive, you could potentially benefit from the planned adjustments or avoid any detrimental effects. The same can be said of the period starting from 2021 as regards making available housing at a reduced price. Your PKF consultant would be pleased to advise you.

StB [German tax consultant] Edgar Weis / WP/StB [German public auditor/ tax consultant] André Jänichen

Gift tax issues related to the reservation of usufruct – Part I: Removing a usufructuary encumbrance

Encumbrance with a usufruct frequently constitutes an impediment to the subsequent sale of an asset. While the consent of the usufructuary is not required for a sale, nevertheless, the rights of the usufructuary would remain unaffected, as it would be merely the owner of the encumbered asset that would change. In this Part I, we have provided some conceptual definitions but the main focus is on the issue of removing the usufructuary encumbrance in the context of gifting. In Part II of our series, which will appear in the next edition of our newsletter, we will discuss what you need to bear in mind in the event of a surrogation.

1. Conceptual and systematic definitions
1.1 Content and legal nature of usufruct

A usufructuary right refers to an in rem right to the use and enjoyment of an encumbered asset. Therefore, the encumbered item may, in particular, be rented out or


Schwerin castle

leased out by the usufructuary on his or her own account, or indeed may also be made available for temporary use free of charge. However, the usufructuary is generally not entitled to impair or alter the substance of the encumbered item or to dispose of it.

1.2 Surrogate for a waiver of the usufruct

In the event of the sale of an asset that is encumbered with a reservation of usufruct, as a rule, the seller should endeavour beforehand to obtain a waiver from the usufructuary of his or her right. To this end, the seller would normally have to offer the usufructuary

» either compensation in the form of a (compensation) payment
» or else usufruct over a replacement asset as a surrogate.

1.3 In personam surrogation by re-establishing a usufruct

If – as is usual – there is no in rem surrogation then, in connection with the waiver of his or her usufructuary right, the usufructuary will have to have such a right granted by contract. A usufructuary right to the sale proceeds or to a replacement asset would then be expressly (newly) granted. From a legal point of view, the question then arises as to whether, in the case of a so-called in personam surrogation, this would in substance still constitute the previous reservation of usufruct or whether the newly established usufruct should be regarded as a donation usufruct.

A surrogate is legally created in two acts. The previous usufructuary right is removed. At the same time, a donation usufruct is established over the new asset.

2. Tax treatment of reservation of usufruct in the case of gifts

2.1 Basic principle

Under the German gift tax law that has been in force since 1.1.2009, the reservation of usufruct results in the full deductibility of this as debt. The calculation involves capitalising the annual value of the usufructuary right on the basis of the statistical life expectancy of the usufructuary determined from the current mortality tables.

2.2 Reduction in the case of exempt assets

However, the principle of full deductibility of a usufruct encumbrance does not apply without any exceptions. In the event of the establishment of a usufruct over assets that are exempt from tax under German inheritance tax law (e.g. company assets) the deductible amount will be reduced in proportion to the amount of basic relief that is granted.

2.3 Example – Gifting of a limited partner's ownership interest

A father F (60 years old) wishes to give a gift of his ownership interest in a limited partnership, with a fair/tax value of € 4 m, to his son S under reservation of usufruct. The conditions for the tax-privileged gifting of business assets

in accordance with Section 13a of the Inheritance Tax Act *(Erbschaftsteuergesetz, ErbStG)* have been met. The annual value of the usufruct is € 200,000.

Limited partner's ownership interest recognised at fair market value in accordance with Section 11(2) of the German Valuation Act	€	4,000,000
Basic relief: 85 %	€	-3,400,000
Taxable difference	€	600,000
Usufruct: € 200,000 x 12.475 = € 2,495,000, deduction of 15 %	€	-374,250
Gain:	€	225,750
Tax-exempt allowance pursuant to Section 16(1) no. 2 ErbStG	€	-225.750
Taxable amount	€	0

In the example, the impact of the usufruct amounts to only 15% since just 15% of the value of the limited partner's ownership interest is taxable.

Advice and Outlook

It is advantageous that only part of the personal tax-exempt allowance is used up and would thus still be available for another gift. In Part II of this series, which will appear in the October edition of our newsletter, we will explain the consequences in the event of a waiver of usufruct or surrendering it and re-establishing usufruct (surrogation scenarios).

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

Consolidated tax groups – Are there additional/ lower profit transfers that are generated apart from tax consolidation

The consolidated tax group for profit tax purposes is frequently characterised as the essence of group tax law. While the tax advantages are indeed substantial, nevertheless, they need to be carefully considered.

These advantages include:

- offsetting losses from subsidiary corporations against the profits of the parent company or other corporations in the consolidated tax group;
- avoiding the notional non-deductible business expenses in the amount of 5% of the profit distribution;
- no capital gains tax on profit transfers.

However, there are unfortunately a lot of requirements that have to be met by those taxpayers who wish to make use of the consolidated tax group option. Even once the high formal hurdles have been cleared, the implementation in terms of accounting and tax returns is difficult. In doing so, so-called additional/lower profit transfers generated prior to tax consolidation as well as in the course of tax consolidation constitute a known minefield. These arise when there are differences between the financial statements and the tax accounts. Furthermore, the German fiscal authority also constructs additional/lower profit transfers generated apart from the tax consolidation, which to some extent has been vehemently rejected in the literature.

In a case that recently came before the Rhineland-Palatinate tax court, the judges rejected the view of the fiscal authority, at least with respect to one point – in the case in question, two subsidiaries, which were not included in the consolidated tax group, were merged into their parent company (upstream merger). Although, the acquiring corporation was a subsidiary (for group tax consolidation/relief purposes) of the claimant. The subsidiaries had correctly been reported at fair market values as applicable under German commercial law and at book values as applicable for tax purposes. This resulted in an additional profit transfer. The parties concerned were able to agree on this point, however, there was a dispute about the issue of whether the reason for this additional profit transfer had arisen during the tax consolidation period (according to the claimant) or prior to that period (according to the tax office).

The legal consequences are entirely different because, under the law, only in cases where the reason for the transfer arose prior to tax consolidation would a profit distribution be deemed to have occurred. This would have led to a profit of around € 600,000 for the claimant.

The judges were however of the same opinion as the claimant and, in this case, basically rejected the notion that the reason had arisen during a period apart from

or prior to the tax consolidation. The wording of the law should not lead to the conclusion that the criterion "during the period prior to tax consolidation" allows any more than an interpretation purely in terms of time.

Please note: The tax office has lodged an appeal against the tax court ruling from 10.9.2019 (case reference: 1 K 1418/18) with the Federal Fiscal Court; the case is pending there under case reference I R 51/19.

LEGAL

RA [German lawyer] Sven Hoischen

Latest news on coronavirus-induced business closure as an insured event

If, in a business closure insurance policy that has been taken out, the insurer undertakes to provide coverage only for the diseases and pathogens "listed below (cf. Sections 6 and 7 of the Infectious Diseases Protection Act *[Infektionsschutzgesetzes, IfSG]*)" then there would be no insurance cover in the event of a coronavirus-induced business closure. This was the decision of Hamm's Higher Regional Court *[Oberlandesgericht, OLG]* in its ruling from 15.7.2020, case reference: 20 W 21/20, which differed from a previous ruling by a Regional Court *[Landesgericht, LG]*.

1. Exhaustive terms and conditions of insurance

In the case in question, the parties had concluded the current insurance contract prior to the amendment of 23.5.2020 to the Infectious Diseases Protection Act (IfSG) and the Regulation on the Extension of the Notification Obligation of 30.01.2020. Hamm's OLG confirmed the negative decision previously issued by Essen's LG with respect to payment arising from a business closure insurance policy. The wording of the terms and conditions of insurance is exhaustive and including the addition in brackets "(cf. Sections 6 and 7 IfSG)" means that there would be no insurance cover for subsequent extensions to the legislation.

2. Deviation from ruling by Mannheim's LG

The decision of Hamm's OLG thus deviated from the ruling by Mannheim's LG from 29.4.2020, which was discussed in the PKF Newsletter 8/20. Hamm's OLG rejected an interpretation towards a "dynamic" reference (also) for subsequent amendments to the Infectious Diseases Protection Act.

Please note: For an evaluation of the obligation of insurers to provide insurance coverage for coronavirus-induced business closures an overview of the agreed provisions and any lists of diseases/pathogens would be of relevance. An addition in brackets "(cf. Sections 6 and 7 IfSG)" would need to be assessed in the overall context.

RA [German lawyer] Johannes Springorum

Brexit and the UK limited – Is an end to the limitation of liability avoidable?

The UK's exit from the EU on 31.1.2020 further raised the pressure on UK Limiteds (Ltds.) registered in German commercial registers. Admittedly, in the Withdrawal Agreement, the EU and UK agreed that the current law would continue to apply during a transition period lasting until 31.12.2020. However, at the end of this period, Ltds. may no longer claim freedom of establishment, which is based on EU law. In Germany, Ltds. would then be exposed to the risk of not being recognised there any longer and their shareholders would be personally liable in accordance with Sec.128 of the Commercial Code *[Handelsgesetzbuch, HGB]*.

1. Legal situation prior to Brexit and ...

Prior to Brexit, 'incorporation' theory based on the EU freedom of establishment provided the legal foundation for the recognition of a Ltd. with its head office in Ger-


Forest lake near Templin

many as a corporation with a legal personality and limited liability. According to the 'incorporation' theory, German company law does not apply to such companies; in particular, this concerns the requirements with respect to the formation of a corporation and entering it into the German commercial register.

Please note: The number of Ltds. in German commercial registers had admittedly already been continually going down prior to the looming Brexit, nevertheless, as at 1.1.2019 there were still approx. 6,500 of them.

… after the transition phase

The consequences for Ltds. with head offices in Germany as of 1.1.2021 will largely depend on whether or not a comprehensive agreement between the UK and EU can be concluded and what it contains.

2. The German perspective – no grandfathering …

In the legal literature it has only occasionally been assumed that, even after Brexit, Ltds. will still be able to invoke freedom of establishment, possibly with the argument that these are based on companies incorporated in accordance with the statutory provisions of a member state. A more prevalent consideration in legal writings is the enactment of a grandfathering provision for Ltds. for a certain period of time. However, it is questionable as to whether or not this could also apply after the transition period as, after all, it would give the Ltds. concerned the option of being operative. Moreover, with the creation of Section 122m of the Reorganisation Act *[Umwandlungsgesetz, UmwG]*, the German government clearly positioned itself against any further grace periods (we have already provided a detailed report on the new provisions of the Reorganisation Act in the PKF newsletter 3/2019).

… but instead the 'real seat' theory will apply …

The predominant view is that the 'real seat' theory – which evolved from German case law pertaining to foreign enterprises from third countries – should apply directly to Ltds. once they are no longer able to invoke the freedom of establishment. According to the 'real seat' theory, the place where an enterprise has its administrative headquarters will be decisive when determining which law system is applicable. According to the settled case law of the Federal Court of Justice *[Bundesgerichtshof, BGH],* this would result in a Ltd. no longer being regarded as a corporation. Instead, a Ltd. would either be treated like a general partnership [offene Handelsgesellschaft, OHG] if it conducts commercial business, or else as a company under civil law *[Gesellschaft bürgerlichen Rechts, GbR*]. If the Ltd. has only one shareholder then it would be viewed as a sole proprietorship by way of universal succession.

… with the consequence that the limitation of liability will cease under English law and …

The shareholders of a Ltd. would no longer be able to invoke the limitation of liability provided under English law and, analogously to Section 128 HGB, would be personally liable for the obligations of the company, or as a consequence of universal succession would become the party that is directly liable. Up to now, there has not been any clarification with respect to the issue of whether this would also apply to old liabilities or only to those that arise subsequent to the change of legal form.

… there is a need for further clarification

Furthermore, following an automatic change of legal form, former directors of the Ltd. who are not shareholders themselves will no longer be entitled to represent the emerging partnership if they have not been authorised accordingly. Moreover, there has so far not be any definitive clarification as to whether or not changing the legal form into a partnership and transferring of assets to the sole shareholder would result in fair value adjustments from the realisation of “hidden reserves“ of the former Ltd company.

3. UK perspective

From a UK perspective, the application of the German ’real seat’ theory and the legal changes in Germany associated with this would have no consequences for the existence of the Ltd. According to the ’incorporation’ theory that applies under English law, the Ltd would continue to exist as a limited liability corporation.

Please note: Accordingly, the legal consequences under German and English law could potentially differ from each other.

4. Problems can be avoided by carrying out a cross-border merger still during the transition period

There is one option for avoiding the negative consequences of Brexit for a Ltd. that can still be used during the transition period, thus at least until 31.12.2020. This would be a cross-border merger with a German company, as was already possible previously for a Ltd. The legal basis for this exists both in Germany, under Sections 122a ff. UmwG, as well as in the United Kingdom, under the UK Companies (Cross-Border Mergers) Regulations 2007; such an arrangement would also be recognised under EU law (cf. ECJ, judgement from 13.12.2005, case: C-411/03, SEVIC Systems AG).

Please note

Based on experience, the above-mentioned merger arrangements would take around three months to realise, therefore, there is now an urgent need to take action in order to still be able to use the transition period to adopt the appropriate measures.

Boitzenburg castle in the Uckermark district

Ismar Nesiren / Christoph Mertens

Liquidity management – Generating cash effects through order-to-cash processes

So-called order-to-cash processes (O2C) cover all the business procedures from the placement of an order up until the payment is received. By using modern methods it is possible to generate significant cash effects at each stage of these processes; an overall improvement of financial planning processes can be achieved almost incidentally.

1. Definition of the order-to-cash process

The O2C process usually begins with customer requests for goods and services, subsequently continues into the provision of those goods and services and finishes up with receipt of the payment from the customer. During this process the same business transaction passes through various items in the P&L, balance sheet and cash flow statement. Sales and liquidity that are anticipated in the forecast turn into actual sales with real cash effects that are reported. Outstanding receivables turn into real cash inflows.

Please note: A well-structured O2C process will secure the operating cash flow, i.e. the liquidity in the business.

2. Liquidity management objectives

Besides receiving payment, the process goal consists in calculating a realistic liquidity forecast of incoming payments. For many companies, efficiently and effectively organising an O2C process with respect to both goals will pose enormous challenges. These arise out of, among other things, large numbers of customers, the amount and quality of daily data updates as well as the involvement of various specialist departments. In particular, answers to the following questions will be of key significance:

- When do the customers actually pay?
- Which customers have to be encouraged to pay and how?

The processing of enormous amounts of data sometimes gives rise to intensive deployment of personnel as a problem that has to be solved. It is important to have a holistic approach to the large number of customers, their invoices and other transactions (e.g. invoice correction, dunning notices, partial prepayments). This is why unstructured processes can result in negative cash effects.

In order to forecast incoming payments, usually, customer receivables including the agreed payment targets as well as open items from dunning runs are processed. A forecast for incoming payment can admittedly be derived from this basis. However, that alone will not result in satisfactory answers to the above questions.

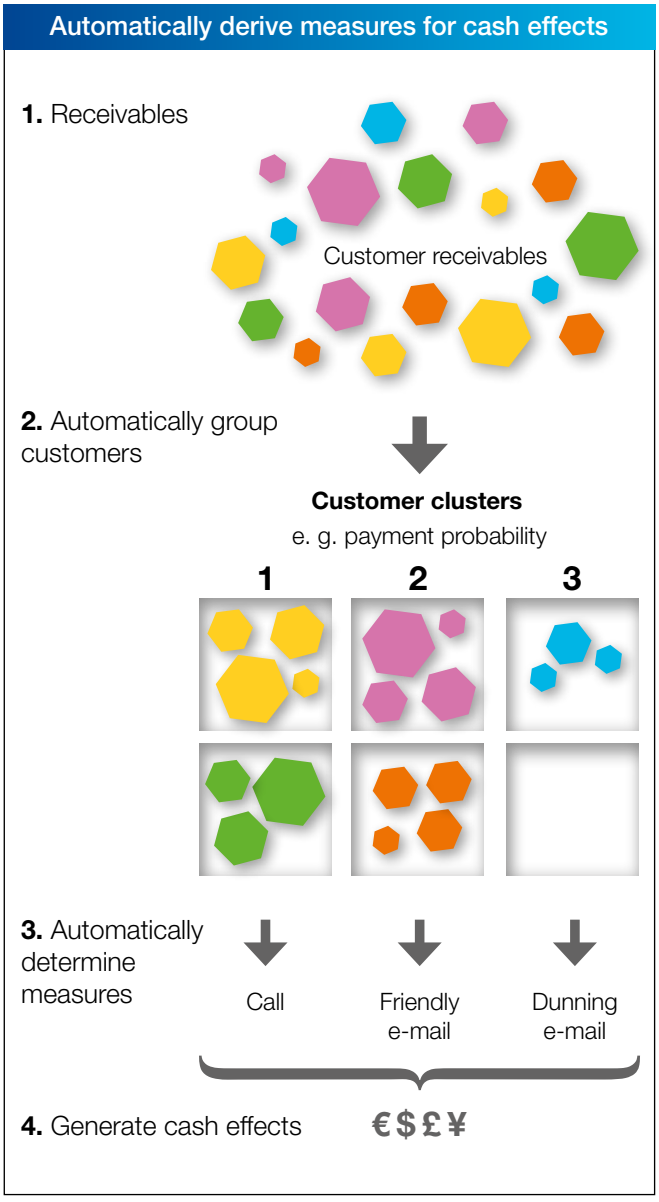


Fig. 1: Deriving cash effects

Recommendation: The management must also have an interest in automating many process steps and also obtaining reliable projections for liquidity forecasts.

3. Approaches to problem solving that are focused on automation and improving quality

There are tried and tested approaches available for the required automation and the desired quality improvements. These can be executed, for example, in the following steps (cf. Fig 1 on p. 11).

(1) Customer clusters – To answer the question when customers actually pay, among other things, historic customer behaviour as well as other appropriate master data can be considered. For example, on the basis of historic receivables and when payment was actually received it is possible to derive conclusions about future incoming payments in the case of regular customers. By contrast, for new customers so-called peer groups can make this possible. With the help of statistical cluster analyses it would thus be possible to create customer groups (cf. illustrative example in Fig. 1) in terms of realistic incoming payments. Statistical methods and support provided by an IT system enable customers to be grouped on the basis of facts. These days moreover there are sophisticated technologies available for this.

(2) Automatically derive measures – In the case of receivables management using large amounts of data, deploying resources efficiently and effectively specifically means that transaction costs have to be reduced and incoming payment maximised. In doing so, statistical procedures replace manual processing of lists of open items (for instance, simply from top to bottom or along a decreasing size of receivable). Automation will enable you to correlate receivables with additional data (such as, for example, historic payment behaviour and previous success of measures) and determine a weighted payment probability and default rate per customer. With such information for each customer or customer cluster you can automatically derive recommendations for actions that can be implemented. The recommendations make it possible to focus on the cases that require undivided attention.

By way of illustration, the example presented in Fig. 2 shows that the underlying statistical procedure can provide valuable information. According to line 4, there is an 80% probability that Cluster Z1,…,p will pay up when an e-mail including a firm reminder are sent. Sending a direct e-mail is thus better since this increases the expected value of the incoming payment by € 40k without tying up further resources. When the amount of receivables is € 1,500k then a cluster with € 50k (3.3% of share of overall volume) would conventionally have low priority in terms of processing. The cluster would have been examined last of all and processed according to the plan (e.g. call first).

Customers	Receivables	Measures
$A_{1,\ldots,n}$	1.000.000 €	1. Call – after the call default rate 0%
$B_{1,\ldots,m}$	450.000 €	2. friendly e-mail – payment probability 95%
…	…	
$Z_{1,\ldots,p}$	50.000 €	3. E-mail with a firm reminder – payment probability 80%
Σ	1.500.000 €	

Fig. 2: Measures derived automatically

(3) Continuously improve forecast quality – The quality of forecasts can be improved if the actual situation that has been realised is routinely compared with the forecast values. It is, in turn, then possible to draw conclusions about the statistical model from these data in order to continuously improve the forecasts. Besides manual checking, it may be appropriate to use artificial intelligence.

Benefits at a glance

- Introducing more structure and more automation to O2C processes will allow precious employee time to be reduced as well fact-based liquidity forecasts to be prepared.
- Moreover, the age structure of the receivables and the administration costs can be reduced and positive contribution margin effects generated. Furthermore, by using customer clusters combined with expectations based on payment track records it would be possible to automatically derive effective measures.
- In this way, companies will be able to purposefully guide actions towards risk issues in order to cut delays in payment together with the process costs.

Determination of profit – Coronavirus emergency relief as taxable income

In a decree from 31.7.2020, the Bavarian State Tax Office clarified that coronavirus emergency relief was taxable.

Companies and the self-employed whose businesses have been damaged by the pandemic are granted financial assistance by the Free State of Bavaria in the form of emergency relief/bridging aid and other support measures. If the eligibility criteria have been met then the financial assistance does not have to be paid back The guidelines in Bavaria include the following information on income tax "... grants obtained for equity reasons are taxable and, in accordance with the general tax legislation rules, have to be taken into account in the course of determining profit". Accordingly, from a profit tax perspective, the financial assistance should be included as taxable operating income. Please note that this will also apply if the financial assistance has been expressly designated for covering living expenses, or was used for this purpose, as permitted.

Please note: We expressly clarify that the argument – which has been put forward to some extent in the literature – according to which the actual intended use is decisive for the assistance to be treated as taxable operating income will not be accepted.

Trade tax add-backs for management remuneration

Trade tax has to be determined by adjusting taxable income as calculated for income or corporate tax purposes for so-called add-backs and reductions (e.g. on account of donations). In this connection, the Munich tax court recently defined the profit shares of partners/shareholders that have to be added back.

The legal action had been taken by a partnership limited by shares (Kommanditgesellschaft auf Aktien, KGaA). The general partner, subject to unlimited liability, was B-GmbH & Co. KG [a combination of a limited commercial partnership (KG) and a private limited liability company (GmbH)] whose share of the capital of the claimant was € 0. In 2011 and 2012, the majority of the limited partners' inter-

Warnemünde

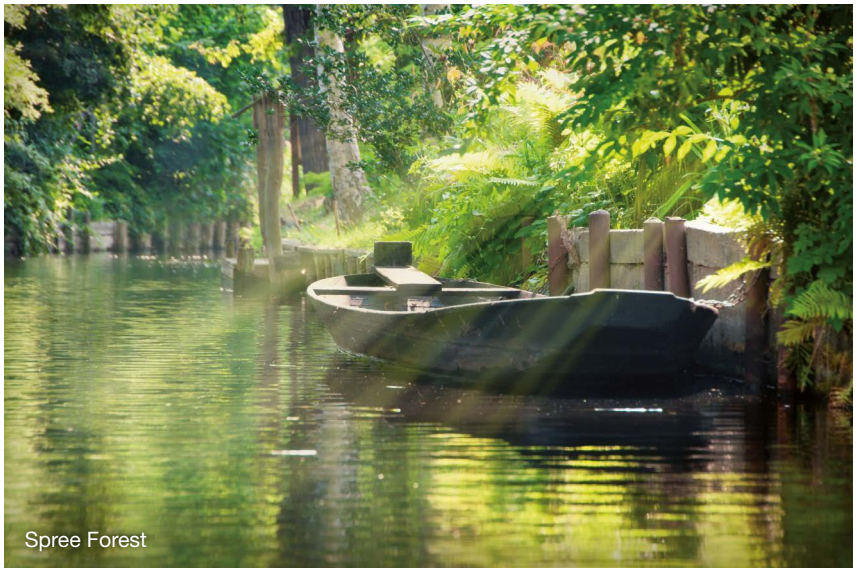
ests were held by G-GmbH and the remainder by natural persons. The personally liable partners of the KGaA (the natural persons) were managing directors and received appropriate remuneration (e.g. salaries and holiday pay) for this. In the course of an external audit at the KGaA, the auditor concluded that all the remuneration – and thus not just the profit-related portion – had to be added back when determining trade tax.

The legal action brought before the Munich tax court was not successful. According to the ruling from 20.2.2020 (case reference: 13 K 1151/17), adding back all the remuneration had been justifiable. In this case, the profit shares that were distributed to the personally liable partners as remuneration paid to managing directors were once again added back to income. It is unimportant here whether or not such remuneration is owed on account of a company agreement or statutes, or because of a separate (in personam) work agreement and how it is designated. Accordingly, there are no restrictions on profit-related remuneration. Furthermore, it is likewise immaterial whether the personally liable partners work as managing directors or just as employees. De facto and from an economic perspective, these managing directors carry out their functions for the account of B-GmbH & Co. KG and, in the opinion of the court, the remuneration should thus be added back. The payroll treatment of remuneration is likewise not decisive for trade tax.

Gift tax liability following a transfer of domicile abroad

Those who transfer their domicile from Germany to another foreign country could nevertheless still be liable to pay tax in Germany. You could be liable to pay tax not just on income that you still draw from Germany but also on gifts. Those who have German nationality will likewise be liable to pay inheritance tax even after they have moved away to another country. Since a claimant was of a different opinion the Munich tax court had to decide on this issue.

The claimant and his mother (both German nationals) each transferred their sole domicile from Germany to Switzerland on 30.11.2011. In a contract from 16.12.2011, the claimant was gifted a property in Switzerland by his mother over which she was granted a lifetime usufruct. In November 2017, the claimant notified the German tax office of this and a gift tax assessment was subsequently issued by the office – the claimant refused to accept this.


Spree Forest

The Munich tax court, in its judgement of 3.7.2019 (case reference: 4 K 1286/18, the appeal before the Federal Fiscal Court (BFH) under case reference II R 5/20 is pending), did not rule in favour of the claimant. Any generous donation between living persons, insofar as this enriches the beneficiary at the expense of the benefactor, would constitute a gift between living persons and thus be subject to gift tax. The gift agreement concluded between the claimant and his mother met the requirements for a gift. As the execution in the land register of the transfer of ownership set out in the agreement was immediately applied for and also subsequently completed, under the law, the gift tax liability arose on 16.12.2011. Furthermore, according to the tax court, there was a so-called extended unlimited gift tax liability. For this, when the tax liability arose, both the benefactor as well as the acquirer would have to have been regarded as German nationals and to have transferred their domicile abroad. This had indeed been the case – both had German nationality and each had transferred their domicile to Switzerland.

Result: A property transfer within a five-year period after transferring your domicile from Germany to a foreign country would thus be liable to gift tax. The Munich tax court judges viewed this provision as being neither unconstitutional nor an infringement of EU law.

Are travel costs that are reimbursed to grandparents for childcare tax deductible?

Travel costs can be tax deductible under certain circumstances. To this end, the Nuremberg tax court recently examined whether or not the travel costs of grandparents who take care of their grandchildren so that their parents can go about their work can be deducted and by whom.

The claimants in this case were parents who, in their tax return, had claimed relief on childcare costs in the amount of € 3,485. Thereof, € 3,149 had gone on travel cost reimbursement for journeys made by the grandparents to the claimants' place of residence in order to look after the children there. For this, together with the tax return, the claimants submitted a summary of the journeys that however included neither a date nor a signature. Moreover, it was not clear who had prepared this summary. There was likewise no invoice. The statements of the amounts transferred to the grandparents contained no reference. In addition, in January 2015, the father of one of the claimants refunded the amount that had been transferred to his bank account. The tax office did not allow the costs to be deducted.

The case before the Nuremberg tax court was not successful. According to the ruling from 20.2.2020 (case reference: 13 K 1151/17), the travel costs were justifiably not taken into account as childcare costs. This was because, in addition to the formal requirements that had not been met, the financial burden was lacking to some extent. Travel reimbursement can indeed generally be taken into account. However, there has to be an invoice for this.

Please note: In the case in question, there was however no written document signed by the parents of one of the claimants from which it could be inferred that the claimants did actually owe their parents for travel costs. Likewise, the claimants' financial burden was lacking, at least to a certain extent, in view of the bank transfer refund.

Tax-exempt property sale – Definition of owner occupation that is deemed to be not harmful prior to the sale

If a property that is held as a private asset is sold during the speculation period then the value appreciation that has been realised has to be taxed as a gain from a private sale transaction. However, under certain circumstances, there could be a tax exemption if the property had been occupied by the owner prior to the sale.

Non-taxation in the case of a sale within a ten-year period requires usage for own residential purposes to have been either

- during the entire period between the purchase and sale, or
- in the year of the sale as well as both the preceding years.

The Federal Ministry of Finance, in a circular from 17.6.2020, has now provided a specific time frame over which the period of owner occupation has to extend in the above-mentioned second scenario. The fiscal authority has applied the newer principles of the case law of the Federal Fiscal Court, from 2019, and now also presumes that the legal requirement of owner occupation "in the year of the sale as well as both the preceding years" would be met if this had been the case

- in the year of the sale at least on 1.1,
- in the previous year continuously and
- in the year before that at least on 31.12.

Therefore, for a tax-exempt sale of a property, it would be sufficient if the period of owner occupation had lasted continuously for a period of one year and two days, although this has to be spread over three calendar years prior to the sale. Thus, in the year of the sale, the property can still be rented out to a third party in the period after 1.1 and until the sale without having to tax the profit on disposal as a result.

Please note: It is however essential that owner occupation in the year prior to the sale is continuous. If, during that year, the property is temporarily rented out to a third party or is left vacant then the subsequent profit on disposal would have to be taxed.

AND FINALLY...

"It is better to make imperfect decisions than to constantly search for perfect decisions that will never exist."

Charles de Gaulle, 22.11.1890 – 9.11.1970, former French general, President 1959 – 1969.

Legal Notice

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