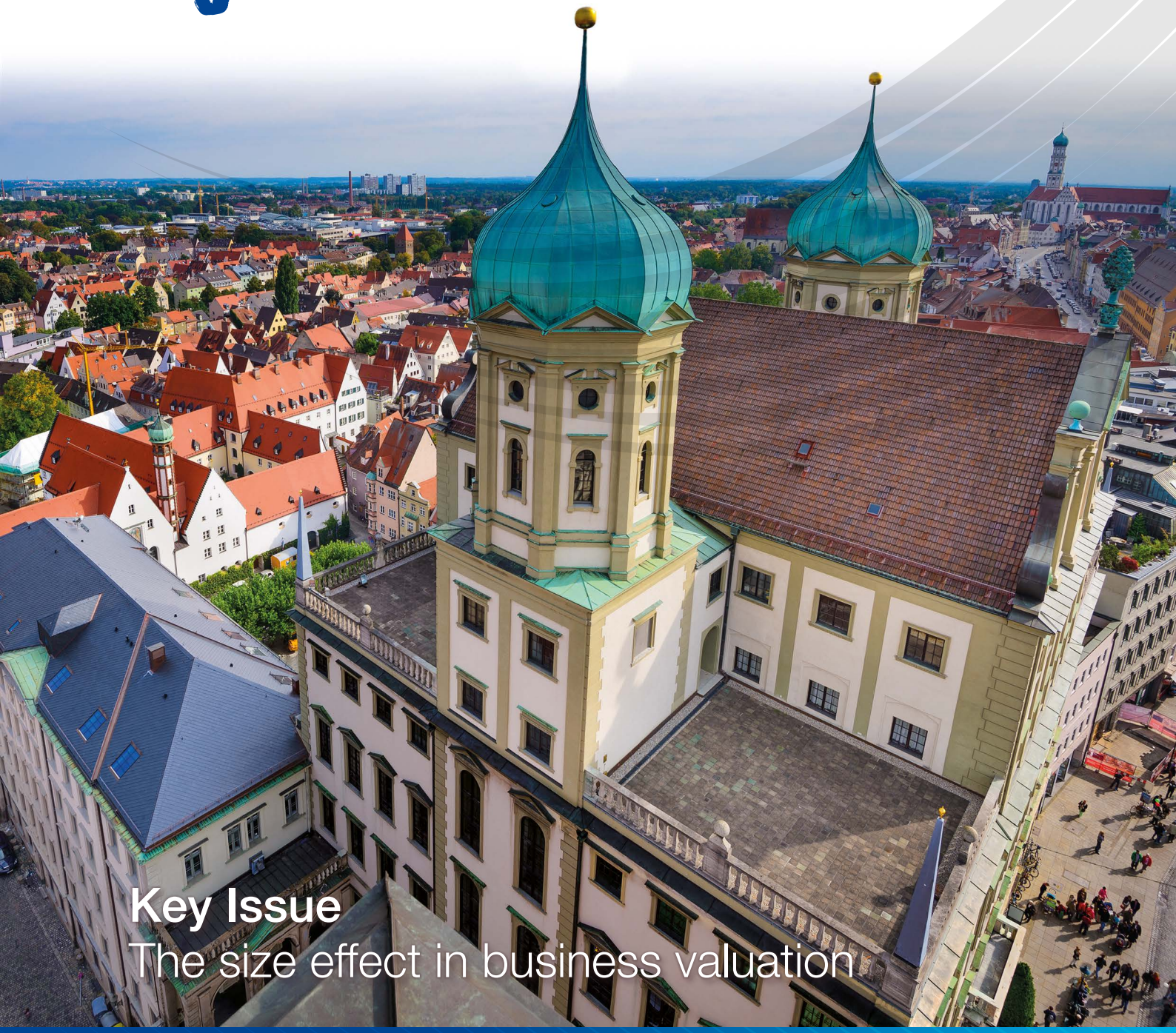
PKF

Newsletter



Key Issue

The size effect in business valuation

09|22

Dear Readers,

The Key Issue report in our September newsletter appears under the Accounting and Finance section. On the financial markets it has been observed that, over longer periods, **smaller companies frequently generate higher returns** than large companies. In our report we examine various tentative explanations for this so-called **size effect**.

Prior to this, we kick off our tax-related topics with a report on how the simplification of intragroup structures frequently happens via a so-called **upstream merger.** However, in **consolidated tax group cases** a circular from the fiscal administration was frequently a hindrance here and triggered significant tax payments. Fortunately, the Federal Ministry of Finance has now come round to the prevailing view and opened up the option of realising hidden reserves under German commercial law in order to avoid merger losses. The topic of group structures is also covered in the second report in our Tax section. There you can read about how **arm's length principles** are being expanded for group financing - likewise for the benefit of taxpayers. Our third report is ultimately about tax deductibility when **royalties are paid to a recipient abroad**. In two circulars, the fiscal administration has expressed its view in this respect on the critical tax rate of 25%.

In the Legal section we discuss important changes made to **employment law** via the **German Act on Notification of Conditions Governing an Employment Relationship**. If, in the future, the detailed information required under this legislation is not included in employment contracts then there would be a risk of compliance violations and fines.

In the final brief reports section, we provide information on important tax-related topics, such as, the new guideline for the apportionment of the purchase price for property acquisitions, outstanding issues related to the recapitulative statement as well as add-backs of rental charges for trade fair stand space for trade tax purposes and the obligation to provide proof of the value of the stake in a company that has been gifted. In addition, there is further legal information, for example, on inheritance law.

We again continue our journey around the PKF locations in Germany through the illustrations that break up the reports from our experts - this time we visit Augsburg.

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

Your Team at PKF

Front cover photo: View of Augsburg from Perlach Tower

Key Issue

The size effect in business valuation

Contents

TAX

StB [German tax consultant] Holger Wandel

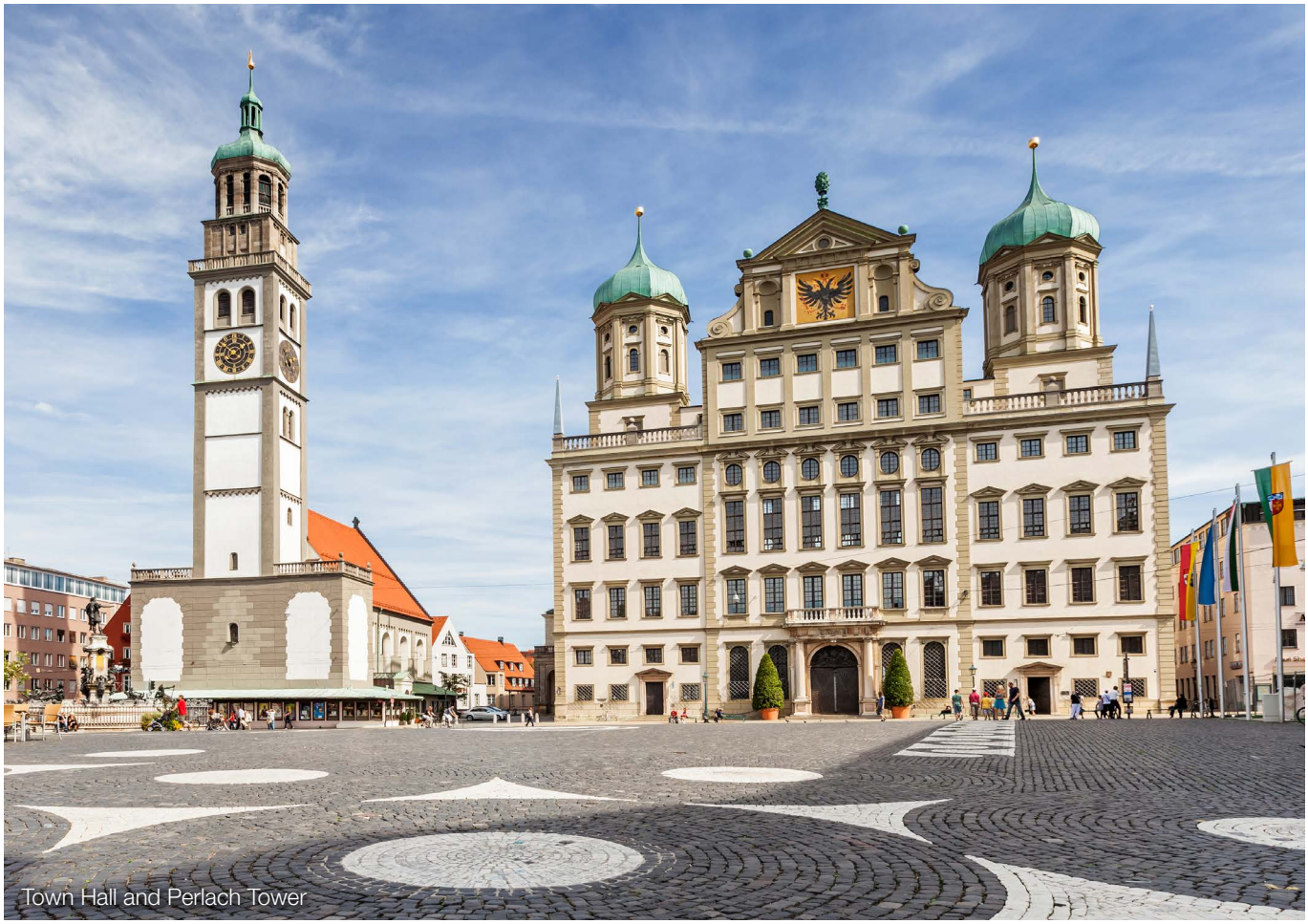
The tax treatment of reorganisation-induced additional transfers in the case of a consolidated tax group

It is the view of the fiscal administration that a merger within an existing consolidated tax group structure at fair market values under German commercial law will result in an additional transfer prior to the tax consolidation that will, in turn, be partly taxable as a dividend. By contrast, the legal literature presents a different view. In a recent judgement, the Federal Fiscal Court *(Bundesfinanzhof, BFH)* has now ruled in favour of the taxpayer.

1. The tax charge in consolidated tax group cases

Within the scope of corporate acquisitions, in the subsequent period, there is frequently a desire to merge the acquired company into a superordinate company. Through the merger, a so-called merger-related loss arises in the amount of the difference between the acquisition costs for the shareholding (for example, €10m) and the acquired company's equity (for example, €1m). This merger-related loss leads to undesired equity situations since acquisition costs will ultimately be cancelled out. That is why there is frequently a desire to avoid this merger-related loss under German commercial law through the realisation of the hidden reserves. By contrast, for tax purposes, the merger can take place in a tax neutral way and with the rollover of book values.

In practice, it is regularly the case that the acquiring group is structured as a consolidated tax group so that, normally, the acquired company is merged into the parent company.



Town Hall and Perlach Tower

The differing amounts stated in the financial accounts and in the tax accounts give rise to additional profit for tax and/or commercial purposes and this leads to a so-called additional transfer. The fiscal administration (Federal Ministry of Finance *[Bundesministerium der Finanzen, BMF]* circular of 11.11.2001, German Reorganisation Tax Decree, Federal Law Gazette *[Bundesgesetzblatt, BGBl]* I 2011 - p. 1314 under paragraph Org. 33) is of the opinion that this constitutes a transaction prior to the tax consolidation. As a consequence, this additional transfer is treated as a dividend for tax purposes. In the case of an additional transfer (in the example, €9m) a tax charge in the amount of approx. € 150,000 would thus arise.

2. A new BFH ruling

The BFH now had to rule on the question of whether such an additional transfer had occurred prior to the tax consolidation, in accordance with the view of the fiscal administration, or whether this constituted an additional transfer within the consolidated tax group, in accordance with the prevailing opinion in the legal literature. Here, the BFH ruled in favour of the taxpayer, in its ruling of 21.2.2022 (case reference: I R 51/19), that, in the case of a merger into an existing consolidated tax group structure, the differences in value that result from this have to be seen against the background of the consolidated tax group on account of the different amounts stated and happens in a tax neutral way. The BFH justified its view by pointing out that in order to make an assessment as to whether there had been an additional transfer prior to the tax consolidation or whether it had occurred within the consolidated tax group, you need to focus on the date of the event that occurred that formed the basis for the difference between the profit transfer in accordance with German commercial law and the net worth increase in the tax accounts. The business transaction that causes a difference to arise between the financial accounts and the tax accounts should be recognised in the accounts for the first time for the period during which the profit and loss transfer agreement had been applicable. Therefore, the BFH treats the additional transfer as if it had been brought about in the consolidated tax group.

3. Impact on practice

In order to avoid the negative consequences, in practice, structures to sidestep these were frequently chosen that were expensive and associated with an increased amount of additional work. In future, it may be possible to dispense with these. It should be noted that the BFH ruling, which is favourable for the taxpayer, has not yet been published by the fiscal administration and, in this respect, there will still be a residual risk in applying it.

Recommendation

For transactions that have already been realised you should make reference to the recently issued BFH ruling. In the case of transactions where there is still structuring potential, where appropriate, you should possibly defer the merger.

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

Cross border group financing – An update on the arm's length nature

The Federal Fiscal Court's *(Bundesfinanzhof, BFH)* ruling on interest rates for shareholder loans has been a subject covered in the PKF newsletter on a number of occasions, most recently in issues 12/21 and 2/2022. In a recent ruling, the BFH has now expressed its view on the arm's length nature of a lack of collateral for cross-border group loans and the potential consequences.

1. Issue and procedural odyssey

In the case in question, a German GmbH [private limited company] had a claim against a Belgian subsidiary company because of a non-collateralised offset account. A debt waiver with a debtor's warrant was agreed and the German parent company wrote off the claim and consequently reduced taxable profit. The local tax office *(Finanzamt, FA)* did not recognise, for tax purposes, the reduction in taxable profit pursuant to Section 1(1) of the Foreign Transactions Tax Act *(Außensteuergesetz, AStG)*. The legal action was successful. Düsseldorf's tax court *(Finanzgericht Düsseldorf, FG)* clarified that "an adjustment to the income pursuant to Section 1(1) AStG would only be possible if "the (appropriateness) of the price agreed upon between the affiliated companies did not stand up to an arm's length comparison." Furthermore, the FG Düsseldorf

criticised that an amount equivalent to the full extent of the write-down had been added back and not the amount of the interest rate differential between the agreed interest rate and an "appropriate" one. The FA had moreover not produced any proof that the agreed interest rate level had been non-arm's length. After the BFH had then ruled in favour of the FA, on 27.2.2019 (case reference: I R 73/16), the Federal Constitutional Court reversed the ruling again, on 4.3.2021, and referred the case back to the BFH.

2. The lack of collateral alone is not a determinant, but rather ...

The BFH, in its ruling from 13.1.2022 (case reference: I R 15/21) now concluded that the lack of collateral for a group loan is not sufficient to allow for a finding of non-arm's length. The Munich-based judges – unlike previously their BFH colleagues in 2019 – were of the opinion that the findings by the lower courts were not sufficient to assess whether or not the reduction in taxable profit, which was based on the write-down of the unsecured loan, had to be adjusted pursuant to Section 1(1) AStG. Collateral is indeed one criterion with respect to the question of the arm's length nature. What matters however is whether or not an unrelated third party would have granted a loan on the same terms – where required, taking into account potential risk compensation. In the view of the BFH, the unrelated third party does not have to be a "traditional bank".

The decisive criterion is that a market can be determined for the agreed loan that can then provide a benchmark for the arm's length comparison that has to be performed. However, if one of the requirements cannot be met – in this case, the lack of collateral – this would not yet lead to an adjustment of the income. In this context, any group support may only lead to an improvement in the creditworthiness to the extent that an unrelated third party would take this into consideration. The case was referred back to the FG because the FG had not dealt with the issue of the arm's length comparison.

3. ... all the objectively discernible circumstances

In the grounds for its ruling, the BFH mentioned three

The Golden Hall in the Town Hall

criteria for the arm's length comparison that have to be taken into consideration:

- capital commitment – a temporary or permanent commitment of capital
- collateral – an assessment as to whether or not third-party lenders would have insisted, ex ante, on collateral
- orientation towards the earnings situation

If an analysis demonstrates that an unrelated third party would have been willing to compensate for the increased risk of default, due to the absence of collateral, in return for a risk premium then a check should be performed to determine whether or not the interest rate that had been agreed complied with the arm's length principle. The comparable uncontrolled price method is normally applied for the purpose of calculating arm's length interest rates on loans.

4. No scope for adjusting the income under AStG

Irrespective of the outcome of the check, there is no scope for adjusting the income under Section 1(1) AStG if there is a market available for unsecured loans and if it can be verified. If the terms were consistent with the arm's length principle then any adjustments to the income could no longer be considered. Even if the terms agreed were not consistent with the arm's length principle, it would still not be possible to adjust the write-down, but instead solely for the amount of the difference between the interest income actually achieved and the amount consistent with the arm's length principle. An adjustment to the write-down under Section 1(1) AStG would only be allowed if, under the special circumstances of a specific case, it was not possible to determine an appropriate market for unsecured loans.

Recommendation

Prior to the conclusion of a group loan, the respective market should be checked. You could make enquiries via a bank, for example. The interest rate for the group loan should then be set on the basis of this market assessment so that there would be a lower risk of an adjustment to the income.

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

The 'royalty barrier' rule – BMF sets out the requirements for preferential regimes

Since the introduction of the 'royalty barrier' rule (Section 4j of the German Income Tax Act), limits have been placed on the tax deductibility of royalties paid by taxpayers in Germany to related parties abroad if, in the recipient's country, the royalty payments are subject to a beneficial tax scheme with tax charged at a rate of less than 25% (preferential regime). These limits on deductibility do not apply if the relevant preferential regime complies with the so-called "nexus approach", as defined in the OECD's 2015 Final Report on BEPS Action 5, "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance". Two new Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* circulars set out the rules for situations where tax treatment differs from the standard tax treatment.

1. Preferential regimes

At the start of the year, the BMF published two administrative directives about the royalty barrier rule. According to the circular from 5.1.2022 (reference: V C 2 - S 2144-g/20/10002 :007) and the one from 6.1.2022 (reference.: V C 2 - S2144-g/20/10002 :005), for a preferential regime, the requisite difference from standard tax treatment will be deemed to exist if a taxpayer with a legal personality comparable to that of the payment creditor, without any concessions, would have had to bear a higher rate of tax. Here, the assumption of a preferential tax regime should not be limited to the well-known IP/patent or licence boxes, but instead should also extend to constellations where arrangements between the recipient of the payments and the foreign fiscal administration (tax rulings) based on individual cases mean that a different taxation comes into effect.

When answering the question as to whether or not the tax rate is at least 25% you need to focus on the tax that is actually levied and paid while deducting any potential downstream refund claims or cross-entity tax refunds.

2. In compliance with the nexus approach

As regards compliance with the nexus approach, the BMF refers to the current, modified classification by the

OECD Forum on Harmful Tax Practices (FHTP); if no respective analysis has been performed by the Forum to date then conformity with the nexus approach has to be determined in the course of the (German) domestic taxation procedure. In 2020 already, for the 2018 assessment period, the BMF published a (non-exhaustive) list of preferential regimes that were classified as not conforming to the nexus approach. At the start of 2022, the respective lists were also published for the 2019 and 2020 periods as well as a list of preferential regimes whose acceptability is currently still under review (as in the case of the US 'Foreign-derived intangible income' regime - so-called FDII). Until the review is concluded, the latter expenditure should, in principle, be recognised as business expenses in German tax assessment notices, although the assessments will be subject to subsequent checking.

3. Burden of proof

In addition to the statements discussed above, the BMF also commented, in particular, on the burden of proof. If the German fiscal administration proves the existence of a preferential regime in a particular foreign country then the taxpayer has to provide evidence that, at the level of the recipient, the payments were not subject to a harmful (or non-compliant) preferential regime. This would generally only be possible by providing the recipient's accounting records (if necessary, supplemented by the basis for the calculations) as well as other documents and data.

Recommendation

As the, in some cases, strict interpretations by the BMF make clear, greater attention will need to be directed to royalty payments to related parties abroad as regards the deductibility of expenses in Germany. It may be necessary for precautionary measures to be taken in good time with respect to preparing evidence. From 2022, at least, it is however likely that the provisions on the royalty barrier will lessen in importance in relation to OECD member states, since they have undertaken to abolish or make acceptable modifications to preferential regimes that do not conform to the nexus approach by 30.6.2021

ACCOUNTING AND FINANCE

Ecem Selamoglu / Norman Sträter

The size effect in business valuation – The causes and risks of higher-than-average returns from small companies

In the context of business valuation, it is always noticeable that, when compared with large companies, small companies generate higher-than-average returns. This so-called size effect appears to create the possibility of generating superior returns on the market through targeted investments in small cap shares. In this report, we analyse the causes of the size effect more closely, although there is a particular focus on the risks of this supposedly promising investment opportunity. As a last point, we present an approach for taking the size effect into consideration in business valuation.

1. Capital market observations on the size effect

One of the first and most extensive studies on the size effect was by two academics, Fama and French, in 1992. The capital market observations made within the scope of this study clearly showed that the return on a share - understood to be the total return – almost continuously decreases as the market cap increases. This size effect was likewise observed by other researchers and in a wide range of capital markets. However, the capital market studies also showed that, over the course of time, the size effect is not stable and sometimes goes through phases when it weakens considerably.

Then again, a look at the recent German capital market returns, in the third quarter of 2022, shows a significantly positive size effect. When the returns from the 40 largest German companies in the DAX index are compared with the 70 small cap companies in the SDAX it is noticeable that the small cap shares in the SDAX exhibited higher returns, on average, than the shares of the DAX companies (as at: 3.8. 2022).

Small companies with low market capitalisation thus appear to generate considerably better returns in the long term. In order to ascertain more precisely what is behind this size effect, in the following sections, we examine the underlying risks and other causes as well as explanatory hypotheses.

2. Risk analysis

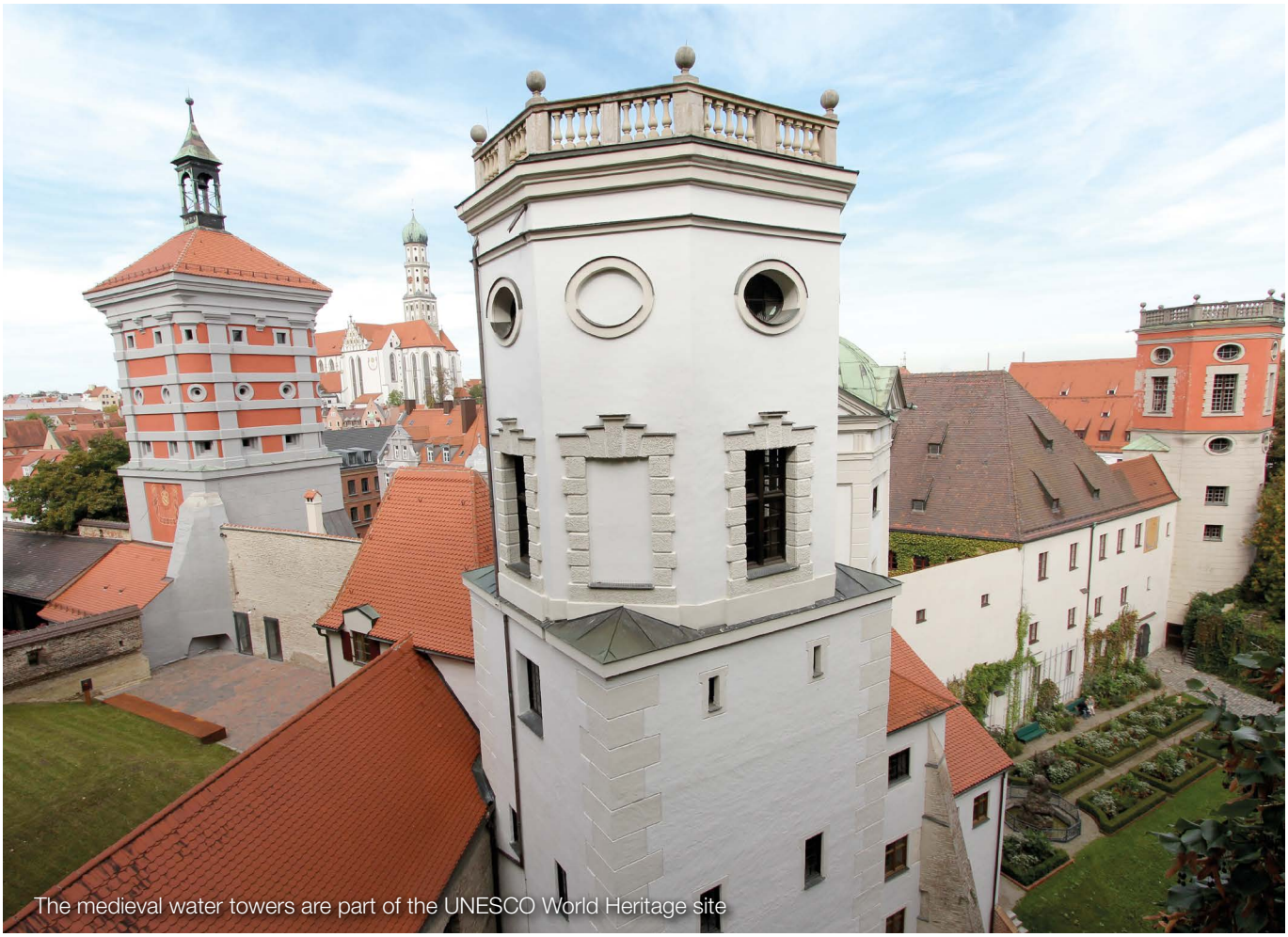
The most frequently cited explanation for the size effect is, arguably, the assumption that small and large companies are differentiated on the basis of their risks and, for this reason, different returns can be expected. This effect is amplified by the fact that, for valuation purposes, the Capital Asset Pricing Model (CAPM) is generally used. However, given that within the scope of this valuation model it is only systematic market risks that are taken into account and not company-specific or non-systematic risks, such as company size; even on a risk-adjusted basis there are discrepancies between the returns for small and large companies.

In addition, small and large companies exhibit major differences in their liquidity or the tradability of their securities. The shares of small companies are generally considered to be illiquid and are, therefore, subject to a higher liquidity risk. This increased risk is associated with a correspondingly higher required rate of return that, in turn, impacts the return that is actually observed on the market.

Furthermore, when comparing small and large companies, it is noticeable that small companies are affected by insolvency risks to a greater extent. Frequently, in terms of capitalisation, small companies are in a less favourable position and therefore have a higher default risk. This increased risk of small companies likewise justifies an additional risk premium that has quite obviously not been addressed by the CAPM. As a consequence, positive excess return effects ultimately develop that explain the size effect.

3. Investor behaviour

Besides the observed risk factors, aspects from the area of behavioural finance can also be used to account for the size effect. Such tentative explanations are generally based on the irrational behaviour of capital market operators. A well-known phenomenon in financial market theory is the so-called overreaction hypothesis. The argument here is that small companies are generally ones



The medieval water towers are part of the UNESCO World Heritage site

that, in the past, often demonstrated poor performance. If investors now overrate the past performance then the share price of small companies will be too low and, by implication, will result in higher returns once the overreaction has ultimately been corrected.

Another behaviour-oriented tentative explanation relates to investor sentiment. Various studies have found that, in this respect, investor sentiment and the size effect are negatively correlated. That means that the size effect is at its weakest when investor sentiment is positive. The reason for this is that, during times of optimistic sentiment, investors tend to overvalue the securities of more risky companies - such as, e.g., small companies. However, when viewed over a longer time period, this results in lower returns since the mispricing of the share will be corrected and it will revert to its fundamental value.

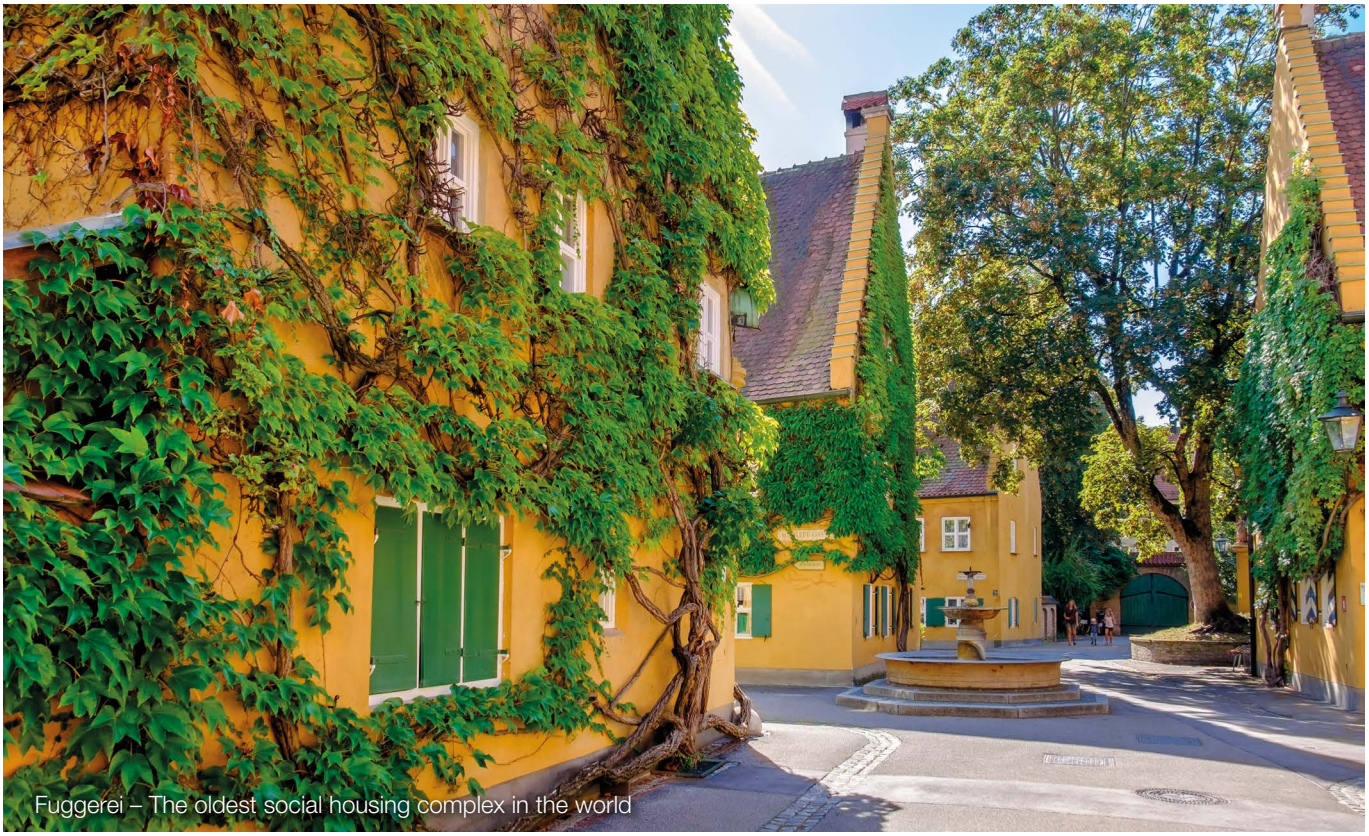
4. Other explanatory hypotheses

Besides the above-mentioned risk and behaviour-based explanations, there is a range of other explanatory hypotheses for the size effect. This is, among other things, also frequently linked to the prevailing phase of the economic cycle. This means that the size effect will be amplified during expansion phases while during recessionary market phases it will weaken or be negative. This was the case, for example, during the 2007- 2008 financial crisis. During this economic phase, there was a decline in the development of returns for small cap shares and this was considerably below the return for large cap shares.

Furthermore, it is well-known that the shares of small companies are generally given less attention by analysts and the media. In this respect, researchers have found that the shares of neglected companies generally achieve higher returns than large companies that are covered and scrutinised by equity analysts on a regular basis. This phenomenon is also known as the so-called neglected firm effect.

Outlook

In order to take proper account of the size effect within the scope of business valuation, several academic researchers have developed alternative calculation models to the CAPM that price in company-specific factors, such as size, in addition to the systematic risk (beta factor). An example worth mentioning here is the Fama-French Three-Factor Model In view of the complexity of this and other multi-factor models, in the USA, the so-called Modified CAPM (MCAPM) has become established for business valuations - it takes the size effect into account with an additional size premium.



Fuggerei – The oldest social housing complex in the world

RAin [German lawyer] Katharina Stock

Fines for employers for infringing documentary evidence requirements

As part of the implementation of EU Directive 2019/1152 on working conditions, the Act on Notification of Conditions Governing an Employment Relationship *(Nachweisgesetz, NachweisG)* was updated. While, up to now, the NachweisG provided for the essential elements for an employment relationship to be specified without any fines, now, numerous information obligations have been laid down and heavy fines of up to €2,000 will be imposed on employers for each infringement.

1. Information obligation

In future, it will no longer be sufficient to simply make reference to statutory notice periods in the employment agreement. In fact, it will be necessary to specify the specific notice period for the respective length of service. By contrast, it will still be possible to make reference to a collective agreement without defining it. It will also be mandatory to provide information about the written form requirement for a notice of termination and about the three-week period for filing an action following receipt of a notice of termination from the employer.

It should no longer be possible to generally agree probationary periods of six months if this period appears to be disproportionate for the overall length of a fixed-term employment relationship. What that specifically means for fixed-term employment relationships has not been laid down. For those involved, the probationary period allows for the possibility of the short two-week notice period, insofar as this is agreed. The applicability of the German Employment Protection Act only after six months shall apply regardless.

Details on the individual remuneration components, such as, basic remuneration, bonus payments, supplements and allowances as well as overtime payments will have to be provided separately together with the respective payment dates. Besides the agreed working time, from now on, the agreed breaks and rest periods as well as shift systems and the requirements for shift changes will have to be set out in writing.

Please note: If an employer does not comply with the documentary evidence requirements and does not present the essential elements of the agreement in written form then, depending on the infringement, they can expect fines of up to €2,000.

2. A change in the case of expiring time limitations

Employees with fixed-term employment relationships may indicate that they want to continue the employment relationship after the end of the first six months. In the individual case, the employer would then be obliged to provide a justification within one month as to why continued employment cannot be considered. The same applies in cases where temporary employees are deployed. The requirements for the justification by an employer have not been laid down. Having regard to private autonomy, the requirements should however not be set too high.

Please note: In the case of new agreements, the above-mentioned notification obligations should, in cases of doubt, be fulfilled on the first working day; in the case of legacy agreements, employers would have seven days to fulfil their notification obligations once requested to do so by employees.

3. Fines for infringements

If employers do not comply with the new obligations this would not actually result in the employment agreement becoming invalid. However, the employers would risk being fined. A review can occur in the course of a tax audit, customs checks or following reports by third parties. Besides fines, the employer would have to bear the respective burden of proof as regards any terms of the agreement.

Recommendation

The changes addressed here are examples and are non-exhaustive. Employers would be well advised to update their employment agreement templates, or to have appendices with the respective information available.

IN BRIEF

Outstanding issues related to the recapitulative statement

The Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* has once again adjusted the German VAT application decree on the tax exemption for intra-Community supplies. Following publication of its circular of 9.10.2020, outstanding issues arose in practice that have now been clarified in its circular of 20.5.2022.

In the above-mentioned circular from 2020, the BMF had included, for the first time, guidelines on the recapitulative statement (RS) as a condition for the tax exemption for intra-Community supplies (ICS). Since 1.1.2020, accurate information about the respective supply in the RS has been the condition for the existence of an ICS. Here, the supply has to be declared properly, completely and within the stipulated period. Furthermore, the recipient of the supply has to be registered for VAT in another EU Member State. Moreover, the recipient of the supply has to use a valid VAT identification number - which has been issued to them by another Member State - vis-à-vis the supplier.

If a supply has not been recorded accurately in the RS then this may be corrected. The correction has to be made within one month after the company has detected the discrepancy. In this respect, it should be noted that the correction has to be made for the reporting period in which the supply was made, and not for the reporting period in which the error was detected.

In its circular of 20.5.2022, the financial administration discussed the late submission of an RS and supplemented this with an additional example. If an RS is submitted in full only after the submission deadline has passed then the tax exemption should be granted retroactively. The principles in this circular should be applied for the first time to ICS effected after 31.12.2019.

Kongress am Park (Augsburg Convention Centre)

Property purchases – New guideline for the apportionment of the purchase price

Those who buy rental properties are generally interested in allocating as high a share of the purchase price as possible to the building because only this portion of the costs is factored into the assessment basis used to calculate the depreciation for the building and, thus, reduces the rental income. The other share of the total purchase price, which is apportioned to land, may not be depreciated and, consequently, cannot have the effect of reducing the tax liability.

The fiscal administration would generally recognise a verifiable apportionment of the purchase price that is made in a purchase agreement if the value is not merely illusory and does not constitute an abusive tax scheme.

Therefore, in the purchase agreement it is already possible to influence which (appropriate) share of the purchase price may be depreciated in the future.

The Federal Ministry of Finance has now published, on its internet site, an updated guideline on the apportionment of the purchase price in the case of developed real estate. The inputs for the calculation tool include the total purchase price, the living space and usable space, the size of the plot and the indicative land value. The output will then be the calculated individual values for the land as well as for the structures that have been erected; subsequently, these can be expressed - in accordance with their percentage shares - in purchase price portions in €.

Compensation for flight delays between third countries

If a flight is delayed then an airline from the EU has to pay compensation to its passengers if the delay exceeds a certain amount of time. The ECJ was however recently requested by a Belgian court to clarify what rules apply to non-EU airlines.

In the case in question, three air passengers had made a booking, via a Lufthansa travel agency, for a flight from Brussels to the USA. The entire flight, which started in Brussels (EU) and ended up in San Jose (non-EU) was operated by United Airlines, an air carrier based in the USA. The three air passengers reached their final destination almost four hours late. The air passengers assigned their rights to a company that lodged a claim, with a Belgian court, against United Airlines for the payment of compensation.

The Belgian court asked the ECJ about the applicability of the regulation to such a flight connection between third countries. The ECJ, in its judgement of 7.4.2022 (case reference: C-561/20) held the view that air passengers from a delayed flight were entitled to claim compensation from a non-EU air carrier if this company had operated the entire flight on behalf of an EU air carrier.

Outcome: In the above-mentioned case, the passengers had concluded a contract of carriage with Lufthansa and could therefore claim the compensation from the non-EU air carrier.

Add-backs for rental charges for trade fair stand space for trade tax purposes

Recently, the Federal Fiscal Court (Bundesfinanzhof, BFH) decided that rental charges for trade fair stand space that a company rents for exhibition purposes only have to be added back for trade tax purposes if it can be assumed that if the space belonged to the exhibiting company it would be held as its fixed assets.

Generally speaking, rental and lease payments that a business enterprise makes in return for the use of non-current immovable capital assets and deducts in its calculation of taxable earnings have to be added back again, to some extent, for the calculation of its trade tax-relevant trading profit (tax assessment basis). In this way, the earnings power of the business enterprise is supposed to

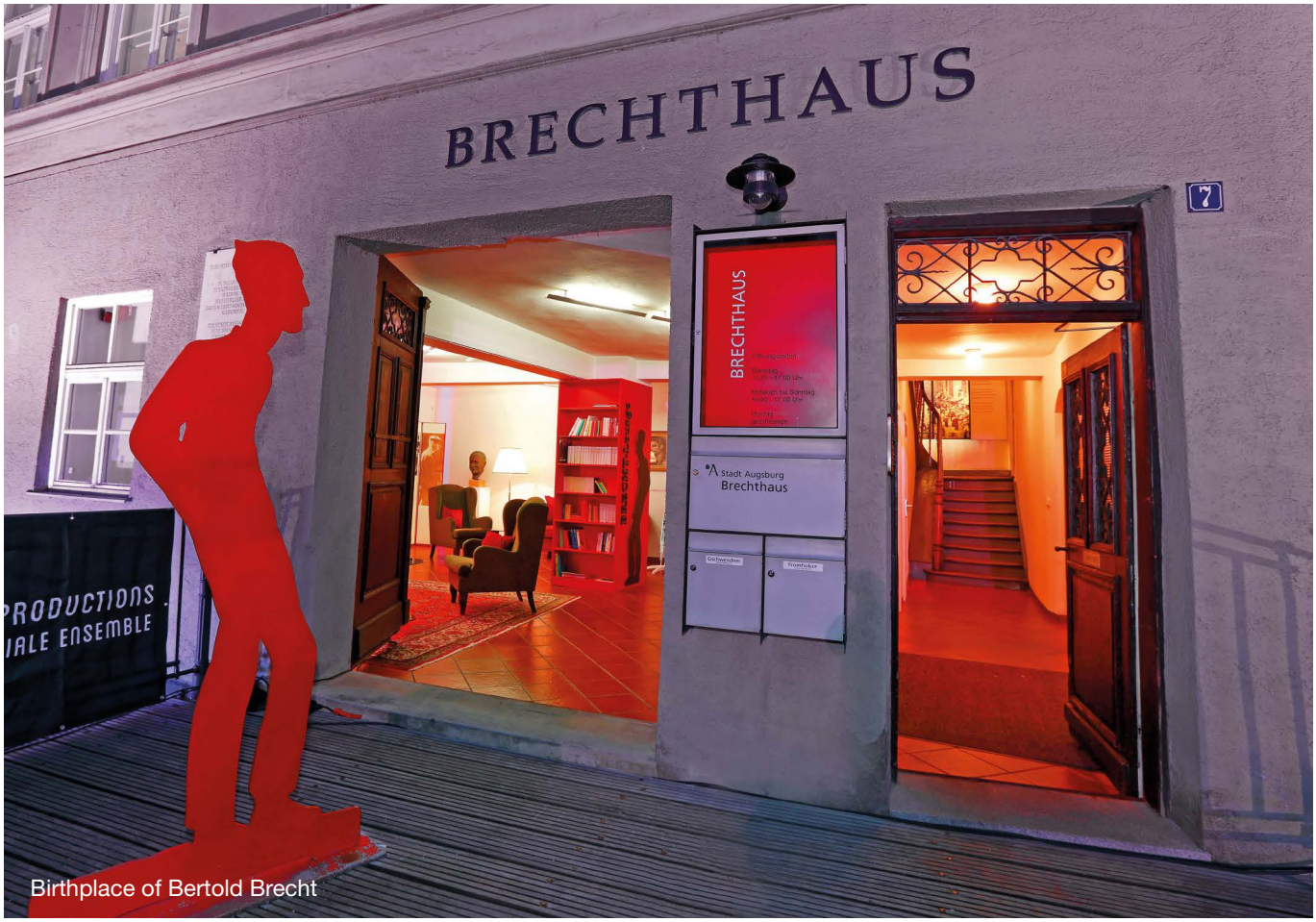
be included irrespective of its equity and debt financing. Against this backdrop, a legal action had been brought by a GmbH [private limited company] whose business purpose was the development, manufacture and sale of machines. In the relevant years, the GmbH had repeatedly rented various exhibitions spaces and facilities at various trade fairs in order to present its products there. It deducted the costs of this from its profits but did not however add back any of these expenses for trade tax purposes. After a tax audit, the local tax office was of the view that the trading profit of the GmbH had to be increased again by a portion of the rental payments.

In the first instance, the Münster tax court, in its ruling of 9.6.2020 (case reference: 9 K 1816/18 G) decided that an add-back should not to be taken into account. The BFH then confirmed this ruling in its decision of 23.3.2022 (case reference: III R 14/21) and made reference to the fact that no notional fixed assets should have been assumed. For classification as a fixed asset, what matters is whether the business purpose of the respective company and also its specific operational circumstances (e.g., the significance of its presence at trade fairs within the distribution system practised by the company) require the permanent availability of an appropriate trade fair space.

Outcome: On this basis, in the opinion of the BFH, the Münster tax court had not erred in law when it had concluded that because of the occasional, short-term nature of the rentals - with due regard to the business purpose and the specific operational circumstances - the trade fair stand spaces should not be allocated to (notional) fixed assets.

Obligation to provide proof of the value of the stake in a company that has been gifted

Recently, the Munich tax court had to rule on the obligation to provide proof of the calculation of the value of the stake in a company that have been gifted. In doing so, the court explored the question of the extent to which the beneficiary is obliged to provide proof that the lower value was applied if



Birthplace of Bertold Brecht

they want to deviate from the methods and valuation parameters specified by law.

In the case that was before the court, the claimants - K and Ms M - were the limited partners of a GmbH & Co. KG (a German limited partnership with a limited liability company as a general partner). On the basis of an agreement dated 29.6.2011, M transferred her stake in the GmbH & Co. KG to the claimant for no consideration. On the basis of the assessment notice dated 13.7.2012 regarding the separate assessment of the business assets for gift tax purposes, the local tax office determined the value of the stake. One month later, the claimant then sold his 80% stake in the GmbH & Co. KG to Y. On 21.10.2015, the local tax office amended the assessment notice and determined anew the value of the stake in the business assets there. The claimant appealed against this because the value that had been determined was too high.

The Munich tax court, in its ruling of 26.1.2022 (case reference: 4 K 1283/20) rejected the complaint on the grounds that it was unfounded. According to the court, the value that has to be applied to the stake is its fair market value. This can normally be derived from sales between unrelated third parties provided that the sales took place less than a year ago. If that is not possible then the net asset value method can be applied. The law does not provide for the possibility for fair market value to be derived from sales that were only concluded after the valuation cut-off date, thus the date of the gifting.

The purchase price agreed between K and Y cannot be used for the calculation of the value of the gift because the sale occurred after the gifting. It was not sufficient proof for the claimant to state that this purchase price had also been applicable on 29.6.2011. Moreover, mere negotiations would not be sufficient for this, since a sale has to actually be executed.

Outcome: In the above-mentioned case, since it was not possible to provide any proof of a lower value on the basis of sales, the local tax office was entitled to calculate the value in a different way, namely, according to the net asset value method. From the mere fact that there was a large difference between the two values it was not possible to infer that they were wrong and that the assessment notice was thus unlawful.

The Berlin-style will *(Berliner Testament)* – Dispositions by childless married couples

In a Berlin-style will *(Berliner Testament)* spouses mutually appoint each other as heirs and determine that the mutual estate will devolve upon a third party only after the death of the survivor. If the married couple do not reserve the right, after the death of a spouse, for the survivor still to be able to amend this disposition subsequently then, after the death of the spouse who dies initially, this disposition may not be amended. Recently, the Higher Regional Court of Düsseldorf had to rule on the interpretation of the interdependency of the dispositions when distant relatives are appointed.

In this case, in 1997, the married couple had initially - on the basis of a handwritten will - mutually appointed each other as sole heirs “in the event of our death”. In 2004, the two had then made a further will and had appointed several individuals as co-heirs, among others, a niece of the testator as well as a nephew of the testator’s wife. Following the death of the wife, the testator had drawn up another will, in 2015, and had drawn up a different disposition as regards the final heirs. The (deceased) wife’s nephew, who had been considered to be a legal heir in the 2004 will, applied for a certificate of inheritance that showed that he was the sole heir. The local court rejected this and the reason that it provided was that, in 2015, the testator had drawn up a different will that was valid.

However, in its ruling of 11.4.2022 (case reference: I-3 Wx 82/21), the Higher Regional Court concluded that, in a case where marriage partners that had remained childless had mutually appointed each other in a joint will as sole heirs and relatives on both sides as final heirs, the testamentary dispositions were interdependent in several respects. In the absence of other indications, this interdependency relates to the married couple mutually appointing each other as sole heirs, mutually appointing and designating their own relatives as final heirs as well as the appointment of final heirs as such.

Outcome: The nephew was able to obtain a certificate of inheritance on the basis of the 2004 will although the court established that, together with his wife, he had merely become a co-heir.

AND FINALLY...

"Good ideas have to be implemented immediately or forgotten right away. You have to make the first step and the second one will then often practically take care of itself."

Oliver Ingo Blume, born on 6.6.1968 in Braunschweig, German manager, former CEO at Porsche AG and, as of 1.9.2022, CEO at Volkswagen AG.

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