PKF

Accountants &
business advisers

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Editorial

Dear Readers,

Following the overview of PKF's Tax CMS Model and the explanations about Phase I (Tax Compliance Analysis) in the last two issues of the PKF Newsletter, we begin this summer double issue with **Risk Analysis (Phase II)**. The main focus is the **module** for **GoBD**, which is the German abbreviation for the principles of proper keeping and retention of accounts in electronic form as well as of access to data. At first glance, this may not sound very exciting and compliance with these principles would indeed appear to be a given. In fact, a systematic implementation of these requirements will however provide the basic framework for all other matters that need to be considered with respect to ascertaining if tax compliance has been achieved. It would thus be advisable to commence the risk analysis with the steps of documenting processes and controls. The milestones are the detailed **documenting of procedures and processes** and so we have provided a summary for you as to how this documentation should be structured.

In the Tax section we, first of all, report on the changes announced – under the confusing motto of: "Against fraudsters. Against tricksters." – to Real Estate Transfer Tax in the case of **'share deals'**. Moreover, you can read about how the German tax authorities are planning to extend the scope of the **obligation to report tax planning arrangements** so that it will not be just a compulsory international routine but will include a national freestyle section, too. In another contribution, we discuss the tax obligations that arise when **employees are seconded** abroad.

In the Legal section, we take a look at a change in the **law on contracts for work and services** that has gone largely unnoticed but will have an effect on the execution of services and, e.g., the realisation of IT projects. Another report makes it clear that good old HGB (the German commercial code) has by no means outlived its usefulness, even if a group prepares its accounts according to IFRS. In any case, not when the **Federal Labour Court** focuses on accrued **pensions** in Germany.

We hope you have a lovely summer and a relaxing holiday while reading this newsletter.

Your PKF Team

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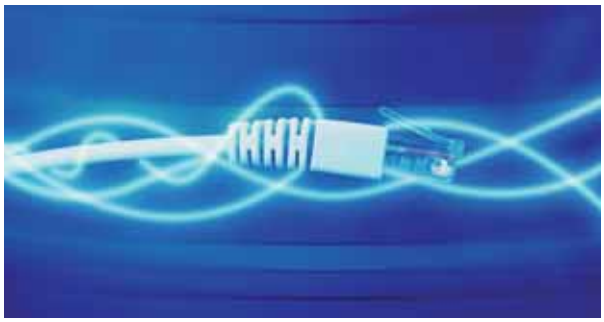

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FOCUS

Tax Compliance Management Systems – Part C: Risk Analysis using the example of the GoBD (Phase II of the PKF Model)

In Phase I of the PKF Model – tax compliance analysis – which we described in our last newsletter, a rough analysis is performed of the standard modules for the (German) Principles of Proper Keeping and Retention of Accounts, Records and Documents in Electronic Form as well as Access to Data (abbreviated in German to GoBD), including documentation relating to procedures and processes, VAT, payroll tax/social security, tax on earnings and deferred taxes, international tax law and transfer prices. The result of Phase I is a decision as to which modules are going to be analysed in detail in Phase II (please see the May issue of our newsletter for a complete overview). Phase II, first of all, consists of an analysis of the extent to which there are controls and measures for the individual risks in the selected modules in order to reduce the amount of a potential loss as well as the probability of these risks occurring. In the following section we outline how documentation relating to procedures and processes should be organised for the GoBD module in order to ensure tax compliance in this respect. Process documentation is particularly important here as, for almost all businesses, it forms the basis for the other Tax CMS modules.

1. Legal requirements and GoBD

According to Section 146(1) of the Fiscal Code (Abgabenordnung, AO) as well as Section 239(1) of the Commercial Code (Handelsgesetzbuch, HGB), bookkeeping entries and other required records shall be made separately, completely, correctly, and in a timely and orderly manner. The tax authorities have specified what this means when information and communication technologies are used, as follows: "The taxpayer has to ensure that electronic bookkeeping entries and other required electronic records are made completely, correctly, in a timely and in an orderly manner from both the organisational perspective as well as the technological perspective." (Subsection 82 of the GoBD).

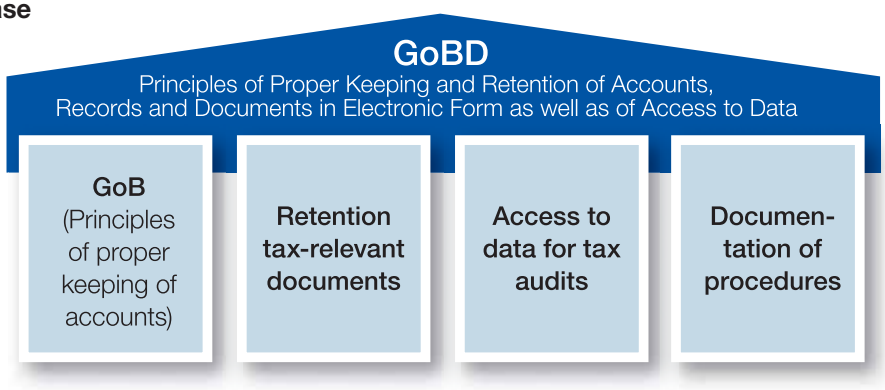


Fig. 1: The basic elements of tax compliance

Businesses that use IT systems for the keeping and retention of accounts, records and documents have been obliged to comply with the requirements in the Federal Ministry of Finance *(Bundesministerium der Finanzen, BMF)* circular from 14.11.2014 (reference IV A 4 – S 0316/13/1003) since 2015. In accordance with the principles of proper keeping and retention of accounts, records and documents in electronic form as well as of access to data (GoBD principles), all electronic business documents that are subject to a retention obligation – especially data that are tax relevant – have to satisfy the requirements with regard to data security, inalterability, retention and machine analysability. The GoBD principles can be structured as shown in fig. 1.

The audit trail for and the verifiability of the first three subject areas have to be ensured through a detailed documentation of procedures. This documentation can in turn be subdivided into four parts (more about this in section 3). User documentation – described in more detail in section 4 – assumes the greatest importance. This is understood to be process documentation including a presentation of the internal measures and controls. In section 5, we have provided a structured summary of the GoBD principles in terms of their contents – in the BMF circular from 14.11.2014 these extend over the first 30 pages.

Please note: A breach of GoBD can lead to the validity of the financial accounts being rejected by the tax auditor and estimates being used to determine the basis for tax calculations.

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

2. Overview of Risk Analysis in the GoBD module

The analysis of whether or not there is compliance with the requirements under GoBD has been allocated to Phase II of PKF's model for a Tax CMS. The aim of the analysis is to determine

- if the documentation of procedures exists in principle and
- if it is consistent with the requirements under GoBD.

The key object of the risk analysis is the process documentation including a description of the internal control system.

2.1 The documentation of processes

The actual risk analysis in Phase II, generally and for all modules, relies on the process documentation. If this does not yet exist, or is not complete then, together with the company, it has to be prepared. Here, first of all, the processes that are tax relevant are identified and described. Two methods can be considered for this purpose:

- Retrograde – Recording of all processes starting with the annual financial statements, tax returns and tax declarations right down to the underlying accounting transaction. The retrograde approach ensures that all the processes are covered that relate to the data that are included in the taxable amount.
- Progressive – The starting point here is the accounting transaction that ultimately ends in the annual financial statements, tax returns and tax declarations.

» **Please note:** In the case of the GoBD module, in addition to the basic precondition of actually having process documentation, this also has to be "module inherent" and supplement the documentation of procedures. The documentation of procedures generally and process documentation in particular are presented in detail in sections 3 and 4.

2.2 Identification of existing measures and controls

First of all, an understanding is achieved of process workflows as well as the integrated measures and controls by analysing the available process documentation. If the latter is not available then the current process workflows, measures and controls have to be recorded on the basis of interviews with the people who are responsible for them. Subsequently, the understanding of the business processes thus gained has to be verified and any missing information has to be added to the process descriptions, in the course of the process, in discussions with the people who are responsible. The result of recording the process is presented in a Process Control Matrix, which is described in detail in section 6.

2.3 Determining process risks

With process risks a distinction is made between:

- (1) inherent risk,
- (2) control risks that arise from processing business transactions,
- (3) risks that arise from the IT support for the processes.

(1) The inherent risk describes the risk that a business transaction carries with it. For example, the processing of a highly complex one-off matter harbours a greater risk than the processing of a standard business transaction where the processing is precisely regulated and has been practised for years.

(2) Control risks arise if the controls (e.g. four-eyes principle) that have to be provided in a process have not been implemented, or not adequately developed, or are not effective. Specifically, these are errors in and contraventions of the process that, despite regulations or internal guidelines, occur knowingly or unknowingly but are not detected through the measures and controls that are part of the existing internal control system.

(3) In the course of the implementation and operation of process-supporting IT systems, various risks can arise in relation to IT processes, IT applications, data, IT infrastructure, IT organisation and the IT environment. IT risks increase in tandem with the complexity of IT systems and the rise in the number of processed business transactions.

When identifying process risks, the question that arises is what errors could occur in the course of the individual process steps when determining the taxable amount. The starting point here is typically the tax requirements that have been specified and then questions are asked as to whether or not compliance with individual requirements could be put at risk due to an error in the process step. The process risks are determined on the basis of the criteria that are presented in detail in section 5.

2.4. Assessment of the risks in relation to the extent of potential loss and occurrence probability

A distinction has to be made between

a quantitative and a qualitative assessment.

(1) If the extent of the financial loss (increased tax assessment, ancillary expenses related to taxes, etc.) can be ascertained then there is a quantitative assessment of the identified tax risks and/or process risks while taking into account existing rules and controls for the respective extent of the financial loss. Furthermore, the occurrence probability for the individual risks is estimated. The so-called net risks result from the multiplication. These net risks form the basis for the design of other measures and controls in Phase III of the PKF Model.

(2) If the extent of the damage cannot be quantified (reputational damage, consequences under criminal law, etc.), then a qualitative classification into risk classes is performed.

3. Documentation of procedures

The documentation of procedures in accordance with the GoBD principles is intended for compliance with the legal requirements of the AO and HGB. A specific catalogue of requirements for the design and detailing of the documentation of procedures does not exist. However, according to prevailing opinion, the documentation of procedures should include process documentation as well as a description of the internal control system. The documentation for the IT system should include not only the main, source and ancillary systems but also other hardware and software components as well as the respective interfaces. The document should be organised in accordance with subsection 153 of the GoBD and on the basis of the IDW AcP FAIT 1 (an accounting principle prepared by the expert committee on information technology (FAIT) of the Institute of Public Auditors in Germany (IDW)) and should include the following constituent components:

(1) A general description – A presentation of the general organisation of the business (e.g. structural organisation, organisational chart, roles, competencies, responsibilities), the range of functions and business processes (e.g. workflow organisation, fields of application) and the legal environment (e.g. non-tax-related and tax-related obligations with respect to keeping accounts and records as well as retention requirements and retention periods).

(2) User documentation – This comprises all the information that is necessary for the proper operation of an IT application. Besides a general description of the range of functions and interoperating modules covered by the IT application, this can contain also, very specifically, the type and significance of the input fields used. If standard software is used then the documentation supplied by the manufacturer should be supplemented with information on the user-specific adaptations and documentation of the parameters (customising). Furthermore, process documentation, which is set out in detail in section 4 below, is also subsumed under this point.

(3) Technical systems documentation – This should be understood as comprising a description of the components of the IT system that underlies the documented processes and process functions as well as how they interact. The documentation should provide information, in particular, about the following areas (IDW FAIT 1):

- data organisation and data structures (creation of data records and/or tables for databases),
- modifiable table contents that are used when a posting is generated,
- programmed processing rules including the implemented input and processing controls,
- program-internal error handling procedures and
- interfaces to other systems.

(4) Operation documentation – This consists of a presentation of the organisational processes for the documentation of the proper application of the IT procedure (in particular, a description of the authorisation procedures, relevant workflows and data backup procedures). With respect to documentation, the main focus is on the following aspects:

- compliance with the principle of an audit trail for an expert third party,
- implementation of a process for creating a procedural organisation and organisational instructions,
- generation and safekeeping of documentary evidence of processing and controls (written records, etc.).

4. Process documentation as a constituent component of the documentation of procedures

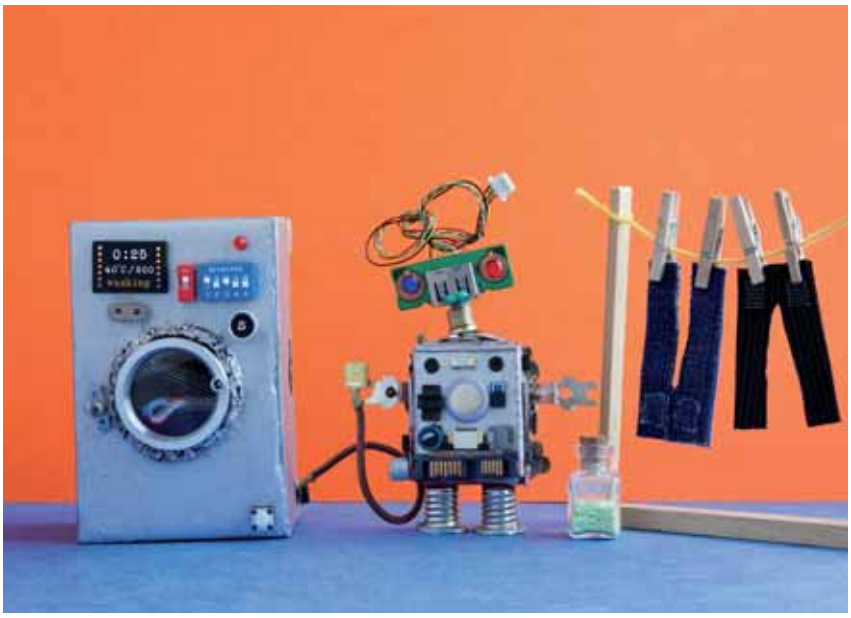
4.1 Process description

A systematic process analysis is the starting point for the process description. Essentially, the question that needs to be asked here is: “who does what, when and with what?”

A member of the company’s staff should thus be able to process the business transactions in accordance with internal guidelines and in conformity with the provisions under tax law. Under GoBD a description of processes that have been implemented organisationally and technically is considered reasonable. The documentation of a process can be organised, e.g., as follows:

- Process Objective
- Scope
- Terminology and Abbreviations
- General Conditions
- General Rules for the Process
  - Entry and Exit Criteria
  - Feedback to the Process Owner (alerting, etc.)
  - Audit Criteria

- Process Model and Activities
  · Roles involved
  · Activities in the Process (process steps)
- Performance Indicators
- IT Systems and Operating Resources
- Other Applicable Documents
- Related Processes



Processes should be described and visualised

The tax authorities have provided an example in the GoBD – A description has to be provided for electronic documents of the organisational and technical processes starting from the generation of the data and including indexing, processing as well as storage, unambiguous retrieval and machine analysability right down to the safeguarding against loss and corruption as well as replication.

Please note: In many cases, process descriptions that already exist (e.g. in connection with an ISO certification) can be used as a basis in many cases.

4.2 Process visualisation

It is advisable to illustrate the descriptions of the processes with images and diagrams. To this end, the descriptions of the processes that are tax relevant should be supplemented with process maps and process flowcharts.

Tools for the design and visualisation of a process (Office applications, process visualisation tools, Signavio, ARIS etc.) are used to produce the process flowcharts. In order to achieve consistency in the presentation across all the processes it is advisable to use a process visualisation framework (Business Process Modelling Notation, event-driven process chains, etc.). For the process documentation, as in the case of all document materials, there is a need to ensure that the changes in the process workflows are described in chronological order (versioning). Furthermore, the change management process has to ensure that any changes to the processes that are tax relevant will necessarily lead to the process documentation being updated.

5. A target system for the Internal Control System within the meaning of the GoBD

The target system for the internal control system (ICS) within the meaning of the GoBD consists of the following constituent elements:

- principles relating to the creation of an audit trail, verifiability, truthfulness, clarity and ongoing recording;
- ensuring compliance with the requirements pertaining to the regularity and security of tax;
- definition of responsibilities.

5.1 Regularity and security

The following requirements pertaining to the regularity and security of procedures and IT systems that are tax relevant derive from the law and administrative opinion (GoBD, etc.):

- vvoucher, journal and account functions
- completeness
- accuracy
- timeliness
- order and indexation
- inalterability
- security
- storage incl. historisation
- making readable and decrypting encrypted data
- ensuring machine analysability in accordance with Section 147(2) AO and
- verifiability of in-house data conversions and proprietary data formats

5.2 Migration and archiving

With respect to migration and archiving, it has to be ensured that the following requirements are satisfied:

- Compliance with the requirements pertaining to regularity under tax and commercial law in the case of migration and in self-sustaining archiving systems
- Providing option of evaluating data that are tax relevant over the retention period (inalterability)
- Data migration or freezing of legacy systems when tax-relevant IT systems are replaced
- Properly transferring data into archiving systems that conform with tax law
- Taking into account the tax requirements relating to in-house formats and data conversions.

5.3. Verifiability incl. access to data by the tax authorities

The verifiability of the basis for tax calculations has to be ensured from both a progressive perspective (from the voucher to the tax declaration) and a retrograde perspective (from the tax

declaration to the voucher). The basis for this is the documentation of procedures. The necessary condition for verifiability is that a right to access to the data on the IT applications is granted for the tax audit. This should be put in place by making the following key arrangements:

- Definition and implementation of user roles for the tax audit: read-only data access (Z1), or additionally with the right to prepare the data (Z2), or the right to data media transfer (Z3);
- Making available verifiable data formats in accordance with the supplementary information on data media transfer in the BMF circular from 14.11.2014;
- Giving due regard to particularities (e.g. setting up a participation process for cash inspections in accordance with Section 146b AO).

6. Process Control Matrix

All the process steps in the process workflow are listed in the Process Control Matrix (cf. fig. 3) and linked to the relevant measures and controls. The controls that have been set up (and planned) for the business are defined and described in a separate list. In the course of this, in particular, the type of control (e.g. preventative, investigative) and its frequency (e.g. monthly, daily, spot check, uninterrupted) should also be designated.

Subsequently, the appropriateness and effectiveness have to be assessed; at any rate, the latter can however only be reliably verified in Phase IV of the PKF Model – "Effectiveness and Review". On the basis of the Process Control Matrix the actual risk analysis is then performed in the Risk and Control Matrix – this is effectively the DNA of the PKF Tax CMS Tool.

Determining process owners constitutes a particular challenge. Process owners are responsible, among other things, for maintaining complete and up-to-date process documentation as well as for the Process Control Matrix.

» **More Information:** In the next issue of the PKF Newsletter we are going to present the risk analysis and risk assessment in Phase II on the basis of the 'payroll tax/social security' tax module.

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Process: GoBD_Documentation of Procedures_Process Documentation (abbreviated in German to GVP)

Process no.	(Sub-)Process	Description	Frequency in the business	System	Measures and controls
GVP_4: Digitise vouchers					
GVP_4.1.1.	Incoming mail and pre-sorting	Paper-based incoming mail is opened, stamped with the incoming mail stamp and filed in a precisely designated place that is protected against unauthorised access.	very frequently	(Specify the filing location)	
GVP_4.1.2.	Incoming mail	Incoming mail is checked for authenticity and external intactness. If there are any doubts then the executive in charge is consulted and, if necessary, the sender or the delivery agent. All critical documents have to be collected in one file document and the outcome of the consultation has to be put on record.	very frequently		
GVP_4.2.1.	Identification of vouchers	The opened, stamped and pre-sorted paper-based incoming mail is visually inspected and checked by the responsible staff member to determine the voucher character of the individual documents. In the course of this, all the documents are assigned a voucher function under commercial and/or tax law and filed in a precisely designated place that is protected against unauthorised access. With regard to the criterion "voucher character", the staff member has a list at his/her disposal that will have been explained in depth to him/her beforehand.	very frequently	(Specify the filing location)	

Fig. 3 Process Control Matrix

TAX

Changes announced to Real Estate Transfer Tax in the case of share deals

» **Who for:** Companies that hold property and their shareholders.

» **Issue:** At the Finance Ministers' Conference in Berlin, on 21.6.2018, – under the Hessian Ministry of Finance's motto of "Gegen Betrüger. Gegen Trickser." (Against fraudsters. Against tricksters.) – the finance ministers of Germany's state governments announced their resolution to rigorously clamp down on share deals with respect to Real Estate Transfer Tax (RETT). This statement is confusing inasmuch as legislators actually created the legal basis for share deals by setting out the situations where RETT would not be triggered in Section 1(2a),(3) and (3a) of the Real Estate Transfer Tax Act (Grunderwerbsteuergesetz, GrEStG) (when it was last amended in November 2015). Yet, it (now) appears to be the case that compliance with these provisions is regarded as abusive.

Although the declaration is essentially based on equity interests in corporations – and a conceptual modification is also planned for these -, the proposed new regulations will also affect partnerships in equal measure. The new regulations that are planned would basically provide for the following amendments and modifications:

(1) New taxable event: transfers of equity stakes – To-date, up to 100% of the shares in property-owning corporations could be transferred without triggering RETT. This was on condition that each buyer separately acquired, or subsequently consolidated, less than 95% of the shares. By contrast, only less than 95% of the shares in property-owning partnerships could be transferred and thus the complete transfer of property-owning partnerships was excluded. In a way, property-owning corporations were thus privileged in relation to property-owning partnerships. This privilege is now supposed to be abolished and, at the same time, changes made to the thresholds that would be to the disadvantage of taxpayers. In future, the transfer of shares in corporations would also incur RETT if, within a period of 10 years, cf. under (2), at least 90% of the shares, cf. under (3), are transferred. Under the new regulations, in future, it would no longer be possible to acquire an entire property corporation, even if there were several buyers who were independent of each other. At least one "existing shareholder" will always have to remain and have a stake of more than 10%.

(2) Extension of the holding periods – The previous holding periods for existing shareholders will be extended from 5 years to 10 years. In future, it would thus only be possible to transfer all the shares in a property-owning partnership or corporation after 10 years; prior to that, only less than 90% of the shares could be transferred.

(3) Reducing the size of a shareholding – The threshold for triggering RETT in the event of transfers of shareholdings is supposed to be reduced from the current level of 95% to 90% in the future (for corporations and partnerships). Accordingly, a transfer of at least 90% of the shares in a property-owning corporation would then trigger RETT on the entire value of the property.

» **Recommendation:** In the light of the political debates in the past, it must be assumed that these proposals will be implemented relatively soon. Any schemes that are currently being planned as regards RETT blocker structures that already exist, i.e. investments in property companies that involve a minority shareholder with a stake of more than 5%, should be swiftly implemented so that they do not founder as a result of the new requirements pertaining to the size of ownership interests or the need for existing shareholders to remain. We will keep you informed about how all other cases should be dealt with where there are existing blocker structures and where a reduction in the size of the shareholding would result in the unification of shares "by operation of law".

RA/StB [German lawyer/ tax consultant] Reinhard Ewert

Property could become even more difficult to shift

Employees abroad – Where do taxes have to be paid?

International double taxation agreements (DTAs) determine the country in which the remuneration of those employees who work abroad should be taxed. In this regard, the tax authorities recently compiled a wide-ranging circular detailing the various requirements for the taxation of income from employment *(Federal Ministry of Finance (Bundesministerium der Finanzen, BMF)* circular from 3.5.2018, case reference: IV B 2 – S 1300/08/10027) and this has thus replaced earlier circulars. In the following section we give an overview of the important points.

Multinational taxation of mobile employees has been regulated – but on 100 pages

1. DTAs – purpose and starting points

International double taxation agreements regulate, on the basis of the OECD Model Tax Convention, the allocation of taxing rights between the two countries that are party to an agreement. In addition, the agreements include techniques for avoiding double taxation that could arise in each case from the tax laws of the individual states. In order to be able to allocate the taxing rights, in the case of employees, this means having to determine, in particular, their 'residency', the 'county where the work is performed' and the 'duration of work activities' in accordance with the DTA .

2. Basic principle – income tax liability in Germany

If an employee is domiciled or ordinarily resident in Germany then he has unlimited tax liability and his entire world income would generally be subject to domestic taxation. If this is not the case then, even if an employee was present in Germany for a short period, certain types of domestic income may be taxed to a limited extent.

3. Residence vs. domicile

While, under German income tax law, unlimited tax liability establishes a comprehensive tax liability, the residency of an individual in one of the DTA signatory states (only) entails the possibility of the DTA provisions being applied to the individual (entitlement to tax treaty benefits). The other signatory state is then the country of source. An individual can indeed have unlimited tax liability in both signatory states (e.g. due to dual domicile), however, s/he can only be regarded as being resident within the meaning of a DTA in one of the two signatory states.

4. Taxation in the state where the work is performed

According to the OECD MTC, remuneration payments can only be taxed in the employee's country of residence unless the work is performed in another country. If the employee performs the work in a different country then it is this state (the country where the work is performed) that is generally entitled to tax the payments that have been received. The place where the work is performed is generally the place where the employee is actually physically present for the performance of his/her work.

5. Taxation in the country of residence

According to the OECD MTC, an employee's country of residence shall have the sole right to tax employment exercised in another country only if

- the employee was present in that other country to perform work for a period not exceeding in aggregate 183 days, and
- the employer that bears the financial liability for the payments is not based in the other country, and
- the financial liability for the remuneration is not borne by a permanent establishment or a fixed place of business that the employer has in the other country.

Only if all three of these conditions have been satisfied would an employee's country of residence be entitled to tax the payments made for work that is performed abroad.

If Germany is the country where the work is performed then, according to

the provisions under income tax law, there should be a review to determine whether the payments to the employee for his/her work performed in Germany are subject to tax there by way of a limited or an unlimited tax liability.

» **Recommendation:** In view of the numerous constellations of working across borders, which are presented in the BMF circular on almost 100 pages, the taxation of employees should be carefully reviewed in each specific case.

StBin [German tax consultant] Sabine Rössler

Obligation to report potentially aggressive tax planning models – Directive DAC6 has been approved

» **Who for:** Intermediaries within the meaning of Directive DAC6, in particular, tax consultants, lawyers and financial service providers as well as certain taxpayers.

» **Issue:** On 25.5.2018, the EU Council approved the directive on mandatory automatic information exchange of reportable cross-border tax arrangements. The directive introduces an obligation to report potentially aggressive cross-border tax arrangements.

Moreover, as only 'potentially' aggressive arrangements are taken into account, in cases of doubt, this could lead to structures also being reported that do not constitute aggressive models, within the meaning of the directive, in order to avoid accusations of a breach of the reporting requirement.

In order to counter such excessive interpretation a motive test should be carried out. Accordingly, the obligation to report only arises if the main benefit of an arrangement consists in obtaining a tax advantage and if obtaining this advantage was the taxpayer's motive (main benefit test). In this connection, the directive specifies other hallmarks that would lead to a main benefit test being satisfied. According to the directive, purely national models are not reportable.

So-called intermediaries (tax consultants, lawyers and financial service providers) are basically obliged to file a report. However, the reporting requirement will directly affect taxpayers if the intermediaries that are involved are bound by law to a professional obligation to maintain confidentiality (e.g. tax consultants, lawyers).

In each case, details of the tax model concerned will have to be reported within 30 days beginning on the day after the arrangement is made available. The information will then be exchanged automatically between the Member States. Penalties and sanctions will be imposed in the event of non-compliance with the reporting requirement. It is basically up to the Member States to decide what the size and form of these penalties and sanctions should be, provided that they are "effective, proportionate and dissuasive".

The Member States have until 31.12.2019 to transpose the Directive into national law. The national regulations would then have to be applied from July 2020.

» **Recommendation:** In the future, in order to avoid penalties, each cross-border transaction should be reviewed to determine whether or not it should be classified as being potentially aggressive – this would thus accordingly trigger reporting obligations.

» **More Information:** The DAC6 Directive (EU) 2018/822 from 25.5.2018 was published on 5.6.2018 in the Official Journal of the EU (reference: L 139/1). It should be noted that, in Germany, the finance ministers of the Länder (the Federal States) decided that the implementation of the EU Directive should provide for extending the scope to include purely national models. Together with the Länder, the Federal Ministry of Finance is checking to see if and, as the case may be, how such an arrangement could be realised.

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

LEGAL

The reform of the law on contracts for work and services and the effects on IT projects

» **Who for:** Contractors that commit to the execution of works or a particular service and purchasers of such works and services.

» **Issue:** The reformed law on contracts for work and services, which has been in force since 1.1.2018, now expressly regulates building contracts for consumers. Furthermore, sweeping changes have been made that could also have an impact on services and IT projects. This includes, in particular, wrongful refusal to accept for which, in the past, the purchaser did not have to state any reasons for the refusal.

In such cases, the contractor was in an unfavourable position as it was obliged to furnish proof that the works were free from defects and thus acceptable.

Under the new regulations, acceptance will now be deemed to have taken place if, after a reasonable time period set by the contractor, the purchaser either fails to respond to the request for acceptance, or refuses to accept the works without stating what the defects are (Section 640(2) German Civil Code, amended version). If the purchasers are consumers then this would however only apply if, in conjunction with the request for acceptance, they had been advised, in text form, of the consequences of not providing information about any defects. The purchaser is able to prevent a fictitious acceptance by giving notice of at least one specific defect within the time period set by the building contractor, although it does not matter whether or not the complaint is about a defect that actually exists, or if the defect is a substantial one or a minor defect. By contrast, if the purchaser does not give notice of any defects in a finished work then acceptance will be deemed to have taken place even if there are substantial defects and the work is not ready for acceptance.

New law on contracts for work and services is particularly relevant in the area of IT

» **Recommendation:** We would be pleased to help you with the interpretation as well as the drafting of clauses in contracts for work and services.

RA [German lawyer] Frederic Schneider

Adjustments to pensions at groups that apply IFRS

» **Who for:** Employers and employees with occupational pension commitments at international groups.

» **Issue:** The case in question was about the obligation to adjust occupational pensions at the defendant employer's organisation, which was a global airline in the legal form of a joint stock company under Canadian law. The airline prepared its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). It had agreed to provide a company pension scheme for its employees, although it stipulated that adjustments to payments after the occurrence of the event giving rise to retirement benefits would be made in accordance with German pension regulations.

The claimant had been drawing a company pension since 2005. The defendant had initially made adjustments to maintain purchasing power but, subsequently, in 2010, 2012 and 2013 the pensions were not adjusted. In her action, the claimant sought increases in her pension.

The Federal Labour Court *(Bundesarbeitsgericht, BAG)*, in its ruling, established important principles for the obligation to adjust occupational pensions (Section 16 of the Occupational Pensions Improvement Act) in an international group. Accordingly, the relevant criterion for a claim to an adjustment is generally the employer's economic situation. This also applies, in the view of the BAG, if the employer's organisation is integrated into a group or is even the holding company for the group. Yet, the consolidated financial statements prepared according to IFRS cannot form the basis for the adjustment. In fact, when determining the economic situation a uniform standard has to apply. This can only be the annual financial statements drawn up according to the German Commercial Code *(Handelsgesetzbuch, HGB)* and which IFRS financial statements are unable to fulfil in the same way because they are restricted to having an information function.

Companies that do not have financial statements drawn up according to HGB do not actually have to prepare these. Nevertheless, companies should present the requisite calculation criteria – such as operating income and the amount of equity – on the basis of the applicable criteria here with respect to financial statements under German commercial law, in a comprehensible way, in order to be able to provide evidence of a bad economic situation.

» **Recommendation:** Even though companies are not obliged to draw up annual financial statements according to HGB, nevertheless, they have to compile and present similar figures in order to provide evidence of a bad economic situation that would preclude an adjustment to pensions.

» **Please note:** The BAG ruling from 12.12.2017 (case reference: 3 AZR 305/16) is available online at www.bundesarbeitsgericht.de (German version only).

RAin [German lawyer] Maha Steinfeld

The inspection rights of limited partners can be excluded

» **Who for:** Shareholders of limited partnerships (Kommanditgesellschaft, KG).

» **Issue:** Under company law every partner with limited liabilities in a KG or a GmbH & Co. KG (German limited partnership with a limited liability company as a general partner) is generally granted the right of scrutiny. S/he can demand a copy of the annual financial statements and check their accuracy by inspecting the books and records (Section 166 of the German Commercial Code *(Handelsgesetzbuch, HGB)*). However, this right is frequently restricted especially at public companies/funds. This was also the situation in a recent pending case. There, in the partnership agreement for a GmbH & Co. KG with150 limited partners, the inspection right was excluded if a Wirtschaftsprüfer (German Public Auditor) provided an unqualified confirmation of the accuracy of the annual financial statements. Despite the fact that the German Public Auditor had issued an appropriate certificate, nevertheless, individual limited partners sought to obtain access to the books and, in the process, invoked their legal rights of scrutiny.

The Munich court of appeals *(Oberlandesgericht, OLG),* in the final instance, has now ruled against the limited partners who made the claim (ruling from 31.1.2018, case reference: 7 U 2600/17). According to this, under a partnership agreement, the rights of scrutiny can be effectively waived. Limited partners are generally in a weaker position than the shareholders in a GmbH (German limited company) whose rights of scrutiny cannot be withdrawn in view of legal provisions that cannot be replaced. The analogous application of GmbH law is thus ruled out.

Reality – shareholders without (information) rights

Moreover, the interests of the limited partners are sufficiently safeguarded here through the requirement for an unqualified certificate from an auditor. However, the court did not clarify whether or not a general exclusion of the inspection right would be permissible even without a requirement for an auditor's certificate, for example, in the case of companies that are not subject to mandatory audits.

» **Recommendation:** Individuals who would like to take a stake in a German limited partnership should carefully scrutinise the partnership agreement with regard to the specific rights of members and not rely on statutory provisions.

RA StB [German lawyer and tax consultant] Frank Moormann

LATEST REPORTS

Additions to working time accounts do not constitute remuneration accrual

Recently, the Federal Fiscal Court (Bundesfinanzhof, BFH), in its ruling from 22.2.2018, (case reference: VI R 17/16, press release no. 30 from 4.6.2018) decided that credits to working time accounts for the purpose of financing early retirement do not constitute the current portion of remuneration accrual and, accordingly, are only taxable during the payout phase. This view is basically consistent with German financial case law hitherto and one that is also essentially shared by the tax authorities. A new element is that this also applies to the external managing directors of a GmbH (German limited company). In this respect, the BFH has contradicted the current opinion of the tax authorities (Federal Ministry of Finance circular from 17.6.2009, published in

the German Federal Tax Gazette (Bundessteuerblatt, BStBl) I 2009 p. 1286). The claimant was the managing director of a GmbH and had no stake in its share capital. He concluded an agreement with the GmbH on the accumulation of credits in a working time account in order to finance his early retirement. The GmbH did not deduct payroll tax from the monthly additions to the working time account.

The BFH did not regard the arrangement in question as a remuneration accrual. At no point whatsoever during the relevant year did the claimant receive either payouts from the working time account nor did he have control of the credit balance. Moreover, the agreement on the accumulation of credits in a working time account could not be regarded as the claimant's advance disposition of his remuneration. In the agreement, the claimant had merely decided to waive part of his salary so as to benefit from a payout later on (during the release phase). It is only remuneration that has accrued that is subject to income tax and payroll tax deductions. In this case, the external managing director should be treated like all other employees; his executive position as managing director is of no relevance for remuneration accrual.

Home offices – Federal Ministry of Finance issues a general ruling against objections

The highest tax authorities of the Länder (Federal States), in a ruling of general application, from 30.4.2018, rejected all pending and permissible objections to income tax assessment notices and declarative statements with which petitioners had opposed the non-deductibility of expenses for a home office that is not used exclusively, or almost not exclusively for business or professional purposes.

According to the latest Federal Fiscal Court (Bundesfinanzhof, BFH) ruling as well as the principles for the income tax treatment of home offices adapted to this by the Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) in its circular from 6.10.2017, the costs of a home office can only be deducted for tax purposes if the room is used exclusively or almost exclusively for business or professional purposes. A low level of joint use (< 10 %) of the rooms is not deemed to be detrimental from a tax point of view, however, a pro rata deduction of costs for workspaces in the corner of a living room or a walk-through room used professionally have been excluded. The reason given for the exclusion is that a not inconsiderable part of the respective area of these rooms is also used for private purposes

AND FINALLY...

„Face reality, even when doing so is uncomfortable, and communicate candidly, even when doing so may sting."

Jack Welch, born on 19.11.1935, former CEO of General Electric (1981-2001). GE, formerly the most valuable company in the world, exited the Dow Jones on 26.6.2018 as its last founding member.

Impressum

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