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### Upper House Takes Position on 2008 Tax Act

In its September session, the Bundesrat (upper house of the German parliament) adopted an official statement of position on the 2008 Tax Act (bill described in *German Tax Monthly* September 2007, page 1). In its position paper, the Bundesrat calls upon the government to reconsider a number of its proposals before the bill comes up for a vote.

With regard to the recapture taxation of carryover EK 02, the Bundesrat wishes to extend elective retention of the current recapture rules to residential construction companies. Regarding the general anti-abuse rule of § 42 AO (General Tax Code), the Bundesrat requests review of the proposed changes to determine whether they would, as currently worded, achieve the desired purpose. Clearer wording is also requested for a number of provisions in the Reorganization Tax Law.

The German government will issue a formal reply to the upper house's statement of position. The extent to which the proposals of the upper

house will ultimately influence the pending legislation needs to be seen.

### German Institute of Chartered Accountants Comments on the Accounting Treatment of Minor Value Assets under the 2008 Business Tax Reform Act

As reported in *German Tax Monthly* June 2007 at page 1, the 2008 Business Tax Reform Act includes a provision on the treatment of assets of minor value. Under the new version of § 6 (2) sent. 1 EStG (Income Tax Law), the full cost of purchasing or producing depreciable movable fixed assets that are capable of independent use must be treated as a business expense in the fiscal year in which such assets are purchased, produced, or contributed if, for each individual asset, the cost of purchase or production, net of the input VAT contained therein, is € 150 or less. For minor value assets with a cost of purchase or production, net of input VAT, exceeding € 150 but less than € 1,000, new § 6 (2a) EStG requires merger into a single accounting item (collective item). This item is depreciated on a straight-line basis over a useful life of 5 years. The new statute

prohibits reductions in the collective item in the event assets cease to constitute property of the business before expiration of their useful life (premature disposals).

The German Institute of Chartered Accountants takes the position that there is no objection in principle to setting up a collective item for commercial accounting purposes as well. It notes, however, that the income tax rules governing the collective item can result in overstatement of its value. The prohibition on adjustments for premature disposals is one aspect that can lead to overstatement. Furthermore, the deemed useful life of 5 years may well be too long in many cases. The Institute of Chartered Accountants therefore permits incorporation of the collective item in the commercial accounts only where its significance is minor. In such cases, an immediate write-off of the entire collective item is also permissible. However, where the collective item is material (e.g. in the hotel or beverage industries), the assumed useful life of 5 years must be reviewed and, where appropriate, shortened to prevent an overstatement of assets.

### **Guidance on the Tax Exemption for REITs**

As reported in the July-August 2007 issue of *German Tax Monthly*, the German Real Estate Investment Trust Act of 1 June 2007 has been promulgated in the Federal Gazette and entered into force with effect retroactive to 1 January 2007. The REIT Act exempts REIT corporations from corporate income tax and trade tax, subject to fulfillment of the

conditions set forth in the law (§§ 8 - 15 REITG). Where these conditions are met, § 17 (1) REITG provides that the tax exemption takes effect at the start of the fiscal year in which the company is registered in the Commercial Register.

The Federal Ministry of Finance has issued guidance dated 10 July 2007 commenting on the procedures followed by the tax administration at the time of application for the tax exemption. Since the documents required for entry of the REIT corporation have already been reviewed by the Commercial Register, the Federal Ministry of Finance states that fulfillment of the requirements for the tax exemption will be presumed by the tax administration as of the time of entry of the REIT in the Commercial Register. The local tax offices are therefore instructed to grant requests to adjust prepayments of corporate income tax and trade tax for these assessment years. The tax offices will thus rely on the Commercial Register and not independently verify fulfillment of the requirements a second time before granting prepayment adjustment requests.

Whether the requirements for the exemption in a particular fiscal year are in fact fulfilled, will, however, as a rule be checked by the tax office after filing of the tax return for the respective year; this will be true even for the first year of the exemption. Verification of the requirements of §§ 12, 14 and 15 REITG will be based on the single-entity or consolidated IFRS financial statements; compliance with the distribution requirement will be

checked based on the financial statements under German GAAP.

### **Guidance on Contributions under the SE Introductory Act**

The tax provisions governing contributions in kind and exchanges of shares were revised in conjunction with the amendments to the Reorganization Tax Law contained in the 2006 SE Introductory Act (Tax Act Accompanying the Introduction of the European Company [*societas europaea* – SE] and Amending other Tax Provisions).

Under the new rules, a tax-free gain on contribution is retroactively taxed in the event the shares taken in return are sold within 7 years of the time of contribution (so-called detrimental sale of shares). In order to enforce the recapture taxation triggered by a detrimental sale of shares, the contributor is required to furnish proof by May 31st of each year as to the person to whom the shares are attributable as of the date that corresponds to that of contribution (§ 22 (3) sent. 1 UmwStG – Reorganization Tax Law). Failure to furnish such proof results in a deemed sale of the shares as of the beginning of the monitoring year in question. This triggers retroactive taxation of the gain on contribution as well as taxation of the gain on sale of the shares.

The Federal Ministry of Finance has now issued guidance on the proof to be furnished under § 22 (3) sent. 1 UmwStG with particular emphasis on the consequences of belated submission of the required proof (i.e. after May 31st of the year in question).

The guidance states that proof submitted after the statutory deadline may still be considered, provided the relevant tax assessment notices may still be amended under applicable procedural law. Where these tax assessment notices have been appealed, submission of the required proof is accordingly possible up to the end of the appeals process.

### **Constitutionality of Commuting Expense Limitations Goes to Federal Constitutional Court; Tax Authorities Will Allow Full Deduction for Wage Withholding Purposes in the Interim**

Since 1 January 2007, the expense of commuting between one's home and place of work has been deductible only to the extent the one-way distance exceeds 20 kilometers. Previously, for each work day it had been possible to deduct € 0.30 for each full kilometer of one-way distance between one's home and place of work (so-called commuter allowance). Two Tax Courts (Lower Saxony and Saarland) have independently concluded that the limit placed on the commuter allowance violates the principle of taxation in proportion to ability to pay, which is derived from Art. 3 (1) of the German constitution (equality before the law). The courts accordingly suspended proceedings and referred the issue to the Federal Constitutional Court for final resolution. Rul-

ing on a motion to stay collection of tax pending a judgment on the merits, the Federal Tax Court has also expressed doubts as to the constitutionality of the new statute (ruling of 23 August 2007 – docket no. VI B 42/07).

The tax authorities responded to the Federal Tax Court's ruling by issuing instructions to grant taxpayer requests to enter a deduction for the first 20 kilometers of one-way distance between home and place of work on so-called wage tax cards, which is the document used by employers to calculate wage tax withholding. Furthermore, the tax authorities declared that all assessment notices issued for the years 2007 ff. will be provisional as to the limited deductibility of commuting expenses. The issue will thus remain open until the Federal Tax Court has rendered its decision. This is not expected to be handed down until next year at the earliest.

### **German Ministry of Finance Reviewing Tax Treaties**

The German Ministry of Finance is currently reviewing bilateral conventions entered into by Germany with other countries for the avoidance of double taxation. The objective is to identify loopholes that permit certain income to escape taxation in either country. The project requires evaluating tax treaties that have in some cases been in force

for many years to determine whether they are consistent with the current fiscal, administrative, and economic exigencies. After completion of a review, the tax authorities intend to pursue amendments to treaties that have been found to be inadequate.

The governments of Germany and Austria have so far been unable to agree on amendments to their inheritance tax treaty. Since Austria will cease imposing inheritance tax from 2008 onwards, amendments to the current treaty are indicated. There is a risk that the situation may ultimately lead to termination of the inheritance tax treaty with Austria.

### **Imprint**

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