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1. *Federal Constitutional Court: decision on commuter tax allowance in December*

The hearing in the „commuter tax allowance“ case took place on September 10, 2008 and the Federal Constitutional Court has stated that it will announce its decision in December of this year.

As reported by the German daily Handelsblatt, the judges revealed their negative opinion of the new regulation by censoring Peer Steinbrück, the Federal Minister of Finance, who was present at the hearing, and by asking him to justify the changes in

the treatment of the commuter tax allowance.

The basis of the dispute is the Grand Coalition’s partial abolishment of the commuter tax allowance effective January 1, 2007 which limited the allowance to commutes exceeding 20 kilometers. This change was based on the belief of the ruling parties that work starts at the “employer’s gate” and that expenses for getting to work are therefore regarded as arising (at least partly) from private decisions with the result that they are not directly related to income and therefore not deductible. Rather than denying the deduction of all commuting costs, however, the coalition introduced a

“hardship-case” exception in the form of the 20-kilometer limit.

Minister Steinbrück also presented this argumentation at the hearing to which one of the judges, Dr. Osterloh, responded that in many cases it is impossible to live next to the place of work. He gave the specific example of the VW factory in Wolfsburg which is situated in a commercial zone in which residential use is prohibited. Additionally, he noted that commuter expenses have so far not been included within the definition of “mixed-cause expenses” (i.e. expenses arising from both private as well as income-related activities).

Mr. Steinbrück further justified the cutback of the commuter tax allowance by noting the need to reduce tax exemptions in order to consolidate Germany’s budget. Judge Osterloh, pointed out, however, that fiscal motives alone are not sufficient to justify a violation of the constitution.

Regardless of such considerations, the cutback could nevertheless be deemed constitutional if it were to be applied more consequently. According to the Handelsblatt, the hardship case regulation may cause the unconstitutionality of the entire regulation which could, however, be remedied by denying the tax allowance in all cases because it remains unclear as to why costs starting with the 21st kilometer should be treated as income-related expenses while the costs of

shorter commutes are regarded as merely private expenses. However, the general question as to the constitutionality of the rule has not yet been addressed. Until the final decision, all possibilities remain open and we will provide further information once the decision is published.

1. **Federal Ministry of Finance: Decree regarding agreements on the facts upon which a tax assessment is based**

Section 88 of the German Fiscal Code (Abgabenordnung, hereinafter “AO”) provides that tax authorities are obliged to determine the relevant facts on which taxation may be based and that settlements in this regard are not permitted.

However, in cases in which a clarification of the facts is complicated, a binding agreement which assumes particular facts and specifies a particular treatment of such facts, is possible. Such an agreement is called a factual agreement (tatsächliche Verständigung).

On July 30, 2008, the Federal Ministry of Finance issued a decree regarding the characteristics and requirements of such agreements. In this decree, the Ministry of Finance noted that a factual agreement is permitted only for the determination of facts and may not include a clarification of legal questions, the occurrence of legal consequences or the application of the law. The main goals of such agreements are the avoidance of disputes and the encouragement of

tax effectiveness and they may be used, in particular, when the fiscal authorities are granted latitude in judgement.

A condition precedent to the conclusion of such a factual agreement is the existence of facts which are difficult to determine. This could be the case, for example, if the amount of time and effort needed to clarify the facts extend beyond reasonable efforts. Furthermore, the agreement may refer to only one factual situation involving a past transaction, must be made in writing including a specification of the agreed-upon facts and must be signed by both parties. Comments on legal consequences normally may not be included in the agreement.

Generally, a factual agreement may be reached by persons who are entitled to issue or receive binding agreements. On the fiscal authority's side this is the public officer responsible for tax assessments. Having reached an agreement which meets the aforementioned requirements, the parties are bound to the facts as agreed and the fiscal authorities are obliged to base the taxation on the agreed-upon facts. Facts which subsequently become known generally will not affect the binding nature of the agreement.

While such an agreement may be rescinded or amended by mutual consent,

the rescission or amendment of an administrative decision based on the facts contained in the agreement is only possible if this is permitted by the law regarding tax proceedings. Nevertheless, factual agreements may be deemed invalid, particularly if they were concluded:

- under the exercise of illegitimate pressure or influence on the taxpayer;
- by a non-competent authority; or
- under a mistaken belief by one party regarding the resulting legal consequences.

A factual agreement may also be deemed invalid if it leads to an obviously inaccurate outcome.

1. Double Taxation Treaty USA: Announcement of amended version, agreement on arbitration, competent authority

On June 4, 2008, the German Ministry of Finance published the amended version of the Convention between the Federal Republic of Germany and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital and to certain other Taxes (hereinafter: "Convention"). The amended Convention includes the convention con-

cluded on August 29, 1989 as well as the June 2006 Protocol amending the 1989 convention.

The amended version in the English language can be found on the internet pages of the German Federal Ministry of Finance at:

http://www.bundesfinanzministerium.de/nr_318/DE/Wirtschaft_und_Verwaltung/Steuern/Veroeffentlichungen_zu_Steuerarten/Internationales_Steuerrecht/DBA/086__an1__engl,templated=raw,property=publicationFile.pdf

Arbitration

In regard to arbitration, the 2006 Protocol implemented mandatory arbitration proceedings for several cases arising from a mutual agreement procedure with arbitration generally required to begin two years after the commencement date of a case.

The competent authorities of the USA and Germany are currently jointly developing procedures for conducting such arbitration proceedings. Until announcement of a final statement of agreement on arbitration rules, the authorities have published interim guidelines regarding the determination of the "commencement date" for mutual agreement proceedings. For example, for cases in which mutual agreement

proceedings were pending as of December 28, 2007 (the date of the Protocol's ratification), that date shall be treated as the commencement date. In other cases, the commencement date of the mutual agreement proceedings shall be the date on which information required for the factual review with regard to mutual agreement proceedings are delivered to the competent authorities.

In regard to requests for the initiation of a mutual agreement proceeding in the US, information to be submitted to the American authorities within the scope of Section 4.05 Revenue Procedure 2006-54 will be deemed required information in terms of the mutual agreement procedure. Under German law, the required information will be deemed to be that information specified in a 2006 Federal Ministry of Finance decree including, specifically, a statement as to the extent to which the taxation under review is not consistent with the treaty. For all those with a special interest in this issue, a copy of this decree is available upon request.

Limitation on Benefits

Section 28 of the Convention provides limitations as to who is entitled to take advantage of the Convention's benefits, stating that only those residents who are "qualified persons" as defined in this Section and satisfy other conditions



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specified in the Convention are entitled to benefits under the Convention.

As an exception, the Convention's benefits may be granted by the competent authority of the Contracting State in which the income in question arises even if the requirements of Section 28 are otherwise not fulfilled. The Federal Ministry of Finance has announced that the competent authority for processing claims for such determinations is the German Federal Central Tax Office.

1. India Double Taxation Treaty: Exchange of information, agreement on mutual agreement

Section 26 of the Agreement between the Federal Republic of Germany and the Republic of India for the Avoidance of Double Taxation with respect to Taxes on Income and Capital (hereinafter "Agreement") includes a so-called "small-disclosure clause" (kleine Auskunftsklausel) which provides that only that information may be exchanged which is necessary for carrying out the provisions of the Agreement.

1. Legislation: Enabling of relocation of electronic bookkeeping abroad

In drafting the Annual Tax Law of 2009, the government has noted its plans to imple-

ment a rule which would allow enterprises to relocate their electronic bookkeeping abroad. Currently, no such relocation is possible under German tax law. * * *

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