Luther.

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Editorial

Dear Reader,

Germany is only days away from national elections and a central topic in the election campaign has been the fight against tax evasion by wealthy individuals and multinationals. Government and opposition are at odds about the legality of buying data of German tax fugitives in Switzerland, a discussion further fuelled by the exposure of Bayern Munich president Hoeness' secret Swiss bank accounts. Peer Steinbrück, the social democratic contender of Chancellor Merkel (and coincidentally also board member of Munich rival Borussia Dortmund), is all set to let "the cavalry ride out against secrecy jurisdictions".

This seems to have become a mainstream position broadly in line with a series of global initiatives aimed at cracking down on aggressive cross-border tax avoidance by multinationals and individuals alike. The European Union has started investigations against Ireland, Luxembourg and the Netherlands as to whether tax concessions given to multinationals (amongst other Apple and Starbucks) constitute illegal subsidies. "Offshore leaks" and reports about Amazon, Google or Starbucks paying no or very little tax outside their home jurisdictions (if at all) have prompted the OECD to come up with an action plan to fight "base erosion and profit shifting" (BEPS). The 15 measures include an automatic information exchange if there is suspected tax evasion and aim to more effectively tax "mobile income". BEPS was fully endorsed by the July meeting of the G8 finance ministers in Moscow and the September G20 summit in St. Petersburg, calling for collective action globally and implementation within the next two years.

If indeed implemented as announced, BEPS could lead to a rather dramatic shift in international taxation. To put it simply, profits shall in future be taxed where value is created – and not where they are shifted within a group of companies to benefit from low or zero tax rates. This is clearly anything but a simple question. In Germany, we still remember the promise made before one of the last national elections to simplify tax rules so that income tax returns fit on a sheet of paper (or a beer coaster as the popular term used at the time) … well, we are not quite there yet and it is plainly not that simple to change complex tax rules, be they domestic or global.

Where do you draw the line between (legal) tax optimization and (illegal) tax evasion, between (healthy) tax competition and (harmful) erosion of the tax base ? This is also a question of perspective and one may wonder how much support the OECD agenda will eventually get from leading economies such as the US and the UK, considering the vital role tax havens within their territories or sphere of influence play in global tax planning. Germany with its strong export-oriented industry naturally is interested in tax transparency across borders, but at a time when tax revenues are at its highest since 1980, the country is not exactly a showcase of eroding tax revenues.

If anything, consensus on the right tax approach will be more difficult to reach internationally than at home. The elections in Germany will presumably provide an answer shortly whether we will have higher taxes on the domestic front, but we may have to wait a bit longer before we see a fundamental change in global taxation.

Best wishes,

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Google held liable for ”autocomplete” function

The German Federal Court of Justice (Bundesgerichtshof, “BGH”) in a widely noted judgment on 14 May 2013 has once again decided on the responsibility of internet service providers for actions of its customers and found that Google can be held liable for its automatically generated search suggestions.

The plaintiff found his personality rights infringed by the suggestions „Scientology“ and „fraud“, which were proposed by the autocomplete function as complementary terms when entering his name into Google Search under “www.google.de”. Google’s search engine includes an autocomplete feature, automatically matching various search suggestions which are displayed in the form of word combinations to the search terms entered by Internet users into the engine. The predictions displayed are determined on the basis of an algorithm, inter alia comprising the number of search queries entered by all users of Google Search, but also considering the content of the displayed webpages.

The plaintiff first obtained an interim injunction prohibiting the prediction of the infringing terms through the autocomplete function. In the subsequent main proceedings, however, the intermediate courts dismissed the claims for injunctive relief, cost reimbursement and remuneration as the predictions could not be ascribed an own meaning, but in fact only referred to the statement that other previous internet users had used the suggested combinations as search terms.

The BGH, however, decided otherwise and held that the predictions „Scientology“ and „fraud“ with their negative connotations infringed the plaintiff’s personality rights. Internet users expected a coherent reference to the search term entered and assumed a material link between the name of the plaintiff and the automatically displayed terms „Scientology“ and/or „fraud“. The infringement of personal rights was also attributable to Google as the predictions were generated through software especially developed for that purpose. Hence, the suggestions were to be regarded as “own” content of Google.

Nevertheless, this does not mean that Google was liable for any personality right infringement caused by such predictions, so the BGH. Google is not obliged to preventively examine all search suggestions for possible infringements, but was rather reproached for not taking adequate precautions to prevent such infringements of third party rights generated by the software. Prerequisite of Google’s liability was therefore a violation of auditing duties after obtaining knowledge of an infringement of personal rights. In this case, it was obliged to also prevent such infringements in the future. If Google failed to take reasonable steps after becoming aware of an infringement, it could be held liable on the basis of the so-called liability for interference (“Störerhaftung”).

Accordingly, aggrieved parties are expected to detect incorrect search suggestions on their own and notify Google thereof. Google is then obliged to examine the alleged infringement, whether it can evidently be considered as a false allegation of fact or unlawful expression of opinion (abusive criticism), and – if applicable – remove the prediction (“notice and take down”) as well as to regularly check and block similar obviously infringing search suggestions. Yet unclear is how detailed Google is obliged to examine the complaint and future predictions and whether the content of the displayed webpages have to be taken into account when assessing an infringement through predictions.

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German Foreign Trade and Payments Act revised

The German Foreign Trade and Payments Act ("Act"), resembling a „rag rug" after numerous changes and modifications, has been considerably simplified, adapted to modern terminology as well as harmonized with European law. A major change is that the intentional violation of foreign trade law now generally constitutes a criminal offence. The changes have come into force on 1 September 2013, together with the also revised Foreign Trade and Payments Regulation.

The essential content of the foreign trade law was not called into question; instead it was streamlined and made easier to digest mainly in the interest of small and medium-sized enterprises in Germany. The complex foreign trade law should now be understandable even to non-lawyers. Besides, the legislator has given up incorporating vague legal concepts as to criminal provisions into the Act, because the courts had concerns in the past as to the clarity of those provisions.

Significant amendments are being made to the criminal law provisions and to the regulation of fines. The changes provide for more clarity in grey areas of law by dividing the provisions clearly into categories in line with the level of accusation. The Act now stipulates, for example, more severe penalties in case of intentionally committed unauthorized exports or violations of weapons embargoes; that applies especially to the intentionally committed unauthorized export of dual-use-goods, which will be pursued in any case as a criminal offence. Generally, many intentional violations which are currently only to be punished as regulatory offences will be pursued as criminal offences in future – while negligent violations will typically only be punished as regulatory offences (with the exception of the reckless infringement of a weapons embargo). Another way to punish negligent violations is to withhold approvals due to insufficient reliability. This is done in order to not criminalize diligent employees who simply made a mistake. Following the practice in tax law, a voluntary self-disclosure is being introduced providing relief to exporters in case of negligent non-compliance with requirements which are of relatively minor importance, such as formalities. In case of criminal offences, exporters cannot benefit from voluntary self-disclosure.

External reporting regulations applying to capital movements and payments will also be affected by these changes. Henceforth, the concerned enterprises have to submit transaction and inventory reports exclusively in electronic form directly to the Deutsche Bundesbank. Submission through banks will no longer be accepted.

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Discriminatory job advertisements may come costly

The German Federal Labour Court (Bundearbeitsgericht, "BAG") has decided that an applicant who is not given the opportunity to attend a job interview may be entitled to immaterial damages under the Equal Treatment Act (Allgemeines Gleichbehandlungsgesetz, "AGG"), even if the employer does not hire anyone for the advertised position. The applicant is not entitled to immaterial damages if the employer can provide evidence that the applicant was either objectively not qualified for the position or abused the law.

The plaintiff, aged 53 at the time, had applied for a job advertised by the respondent. However, the job offer specified for the applicants a desired age of 25 to 35. The plaintiff had only 7 months of working experience on the software required for the position and asked for a high monthly salary. The respondent did not invite the plaintiff to a job interview, but invited only one other applicant who was not hired in the end. The plaintiff sued the respondent for immaterial damages under the Equal Treatment Act.

The BAG confirmed that not inviting an applicant to a job interview for discriminatory reasons constitutes a violation of the AGG. The court held that the respondent's failure to invite the plaintiff for an interview indicated discrimination, given that the plaintiff did not fit within the age bracket the respondent asked

for in the job offer. Thus Section 15.2 of the AGG, according to which immaterial damages can be awarded where an applicant is not employed for discriminatory reasons, was in principle applicable. In opposition to the appellate court's view, the BAG reasoned that a violation of Section 15.2 AGG does not require that the respondent actually employed anyone at the end of the application process. Instead, it is sufficient that the applicant has been denied a potential opportunity to get a job. The BAG stated that otherwise an employer could decide by himself whether he violates the AGG or not and, after realising that he actually discriminated an applicant, just end the application process without hiring anyone and get away with it scot-free. However, the BAG also ruled that the given violation of the AGG does not necessarily trigger a right to damages. The appellate court, to which the case was referred back, now needs to determine whether the respondent legitimately ignored the plaintiff's application due to his lack of qualification or whether the plaintiff's claim was abusive since he was unqualified andasked for an unreasonably high salary.

This decision is a consistent continuation of previous BAG case law. Under the AGG, an applicant is not merely entitled to a non-discriminatory decision when it comes to the employment itself, but also to a whole non-discriminatory application process. The outcome of such a process is not relevant for an entitlement to damages due to discrimination. Therefore, employers need to be aware that merely depriving an applicant of a potential opportunity can lead to a claim.

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Insolvency related termination clauses are invalid

The German Federal Court of Justice (Bundesgerichtshof, "BGH") issued a verdict that is – once again – disadvantageous for suppliers. At least, the decision has brought certainty regarding the validity of insolvency related termination clauses. The clause in question allowed termination of a contract for performance of a continuing obligation in case of the petition for or opening of insolvency proceedings.

Under German insolvency law, the insolvency administrator has the right to discontinue a contract if it was not or not completely performed by the debtor and the other party at the date when the insolvency proceedings were opened. It is therefore up to the insolvency administrator to decide whether he performs such contract replacing the debtor and claiming the other party's consideration. In order to secure this option of the insolvency administrator, any agreements excluding or limiting it are invalid (sec. 119 German Insolvency Statute, "InsO"). Sec. 103 InsO clearly stipulates that this right may be exercised "when the insolvency proceeding was opened" and not before that date. Nevertheless, the BGH ruled against the clear wording for the purpose of facilitating the restructuring of the company. The insolvency administrator must be able to opt for performance of profitable contracts in order to generate as much assets for the insolvency estate as possible. This would be impeded if the other party would be allowed to terminate the contract during the time of the preliminary insolvency proceeding.

Therefore, closer monitoring of the customers' financial status is more important than ever. Having agreed upon termination clauses in case of payment delay or other reasons for termination and cancelling the contract before the petition for opening of insolvency proceedings could be an option to prevent further losses as well. However, matching the right time for termination based on "any other reason" would be a game of luck.

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Changes to German competition law

On 30 June 2013, the 8th Amendment to the Act against Restraints of Competition ("GWB") has finally come into force. It has brought with it in particular significant changes on merger control and abuse of dominance rules. In addition, the Federal Cartel Office ("FCO") has issued new guidelines for the setting of fines in cartel proceedings.

In order to align German merger control law with the respective European regulations, the SIEC test (Significant Impediment of Effective Competition) was introduced. The former substantive test (creation or strengthening of a dominant position) is now an example of when effective competition is significantly impeded. De minimis markets (i.e. markets with a total sales volume not exceeding EUR 15 million in Germany) will no longer be exempted from the notification obligation but are moved to the substantive test for prohibition. Thus, the FCO is able to review transactions relating to de minimis markets but will not be able to prohibit them. A new stop-the-clock provision was introduced for phase II cases in which information requests are not answered on time. Furthermore, the phase II review period is automatically prolonged for one month if the parties offer commitments for the first time during the phase II procedure.

The market share threshold for the statutory presumption of single-firm "dominance" is increased from 33 % to 40 %. In cases of a violation of competition law, the FCO now has the explicit power to impose structural changes on infringers, i.e. it may order that the parties to an infringement dispose of assets or shares.

While there is no specific new regulation in the GWB, the approach to calculating fines has recently changed due to a ruling by the German Federal Court of Justice (Bundesgerichtshof, "BGH"). According to Sec. 81 (4) sentence 2 GWB "the fine must not exceed 10 percent of the total turnover of such undertaking or association of undertakings achieved in the business year preceding the decision of the authority". While previously this restriction has been regarded as a cap, the BGH now ruled that it constitutes a turnover-based upper limit. The FCO has therefore issued new guidelines for the setting of fines in cartel proceedings.

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German Parliament approves Tax Act 2013

The Tax Act 2013 (with the awkward German title "Amtshilferichtlinie-Umsetzungsgesetz") includes inter alia important changes with respect to the taxation of hybrid capital instruments, a new anti-abuse provision for the German Real Estate Transfer Tax (RETT) and an amendment to the German CFC rules with a view to the application of the arm's-length-principle in case of permanent establishments. The changes had been discussed for nearly one year between both houses of German Parliament and have finally been passed this summer.

Restriction of hybrid capital instruments

The principle of corresponding taxation will be extended to so-called hybrid capital instruments for Corporate Income Tax purposes.

Hybrid capital instruments are characterized by the fact that they qualify as debt in a foreign state and as equity in Germany, since Germany and foreign countries do not classify equity and debt on the basis of identical criteria. In the best case, the different classification can result in the deduction of the payment as operating expense (interest) in the source state and as tax-privileged dividend in Germany.

This shall now be avoided by extending the system of corresponding taxation to hybrid capital instruments. The 95%-exemption for dividend income for Corporate Income Tax purposes will only be applicable if and to the extent the dividend received was not tax deductible at the level of the company distributing the payment. The new rule will generally apply as of 2014.

Application of arm's-length-principle to permanent establishments (PE)

On the basis of the Authorized OECD Approach (AOA), the profit allocation in relation to a PE will follow the „Functionally Separate Entity Approach", assuming that the PE is a completely separate and independent unit. Thus, the transfer prices for a PE have to be determined in the same manner as would have to be done in case of a subsidiary.

RETT Blocker Structures

The Tax Act 2013 disallows RETT blocker structures as they had been used in practice in the past. In principle, RETT can be avoided if less than 95% of the shares or partnership interests are transferred. In recent years, so-called RETT blocker structures have been market practice: Purchasers acquired 94.9 % of the shares in a real estate owning company directly and, in addition, through a partnership in which they were a 94.9 % partner, they acquired the other 5.1 % indirectly. By doing so, it was possible to acquire nearly 100 % in the real estate owning company without being subject to RETT.

Under the new wording, the purchaser will be subject to RETT, if the respective transaction results in an "economic" ownership of 95% or more of the shares in a real estate owning company. In determining the economic ownership, direct and indirect shareholdings have to be considered.

Furthermore, the rule for intra-group reorganizations has been amended. So far, the respective provision in the RETT Act only exempts certain intra-group reorganization measures under the German Corporate Transformation Act (Umwandlungsgesetz) from RETT. Now, contributions and other corporate transactions can also benefit from the exemption. However, even after the amendment the requirements for the exemption are tight. As a result, there is still no general rule that intra-group reorganizations are exempt from RETT.

Summary

With regard to the changes aiming at hybrid capital structures and the AOA in relation to German PEs, it is recommendable to review current structures in order to check whether the new rules will have an impact on the German taxation or e.g. documentation obligations.

Future acquisitions and transfers will have to consider the new restrictions in the German RETT Act. As the wording of the amendment is rather opaque, it will be difficult to determine if and when the criterion of "economic" ownership is fulfilled as there are many grey areas, so diligent planning will be necessary.

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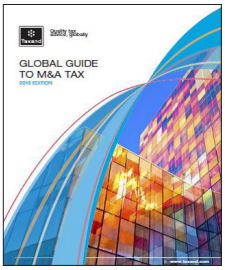
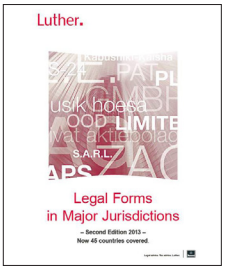
New Publications

The Taxand Global Guide to M&A Tax 2013



The Taxand Global Guide to M&A Tax 2013 answers the top questions dealmakers need to consider when undertaking any buy or sale across 35 countries. As well as providing an overview of the host of legislative change which Governments have introduced over the last year to incentivise M&A activity, this publication highlights the opportunities and pitfalls affecting multinationals globally, covering the varying trends in the Eurozone, the Americas and the Asia-Pacific region.

Legal Forms in Major Jurisdictions 2nd edition 2013



Our manual Legal Forms in Major Jurisdictions has been updated, now providing an overview of common business structures in 45 countries. Major European countries, the USA, Canada, Russia, South Africa, Latin American nations as well as several countries in the Asia-Pacific region are covered. Also included is a comparative chapter on the European stock corporation, the Societas Europaea (SE). This easy-to-use guide serves as a road map for internationally operating companies, specifically at the stage before entering a foreign market.

Electronic versions of both publications are available on our website or please request a copy by email.

Imprint

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