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Group tax considerations not good cause for breaking a tax group agreement

The Supreme Tax Court has held that a sale of shareholdings within a group was not sufficiently good cause for breaking an unwanted German tax group before its expiry date.

A German operating subsidiary of a British group was held by a KG (limited partnership) wholly owned by the Dutch country holding of the British parent company. This four-tier structure was essentially disadvantageous in that it led to UK taxation of German income under CFC rules. However, it also enabled the operating subsidiary to conclude a profit pooling agreement with the KG, its immediate parent, in order to offset its own trade tax profits with the losses brought forward by the latter. Such profit pooling agreements must run for five full years and may only be cancelled for good cause. During the course of the agreement, the KG changed the year-end of the subsidiary and, with the same effective date, sold its shares to the German country holding for the rest of the group's operations. The tax office refused to accept the profit pooling agreement.

The Supreme Tax Court has now upheld the tax office position, although with a more detailed reasoning. Its first point was that the change of year-end meant that the agreement would now run for less than the full five years originally agreed. However, the measure was the agreement at the time of signature. It remained open to the parties to ensure in the final year that it did, in fact, run for at least 60 months, such as by agreeing an extension to the new year-end of the subsidiary. This first finding in favour of the group was, however, nullified by the court's next point, that the sale of the shares in the subsidiary within the group was not a sale for "good cause". It emphasised that the purpose of the provision was to ensure that tax groups were not formed or broken arbitrarily to suit the needs of the moment and a "good cause" could only be accepted as such, if it lay beyond the sole influence of related parties (e.g. a sale of the shares to outside interests). Foreign tax considerations were irrelevant, the more so in this case, given that the UK CFC rules were known when the agreement was signed. The court mentioned the possibility that the parties might have intended on signature to cancel the agreement once its German object of trade tax loss offset had been fulfilled, but did not expand on this beyond saying that such intent would in any case call the five-year minimum period into question. Its conclusion was that a change of circumstance solely at the behest of the ultimate parent did not meet the tax law requirement for the exclusion of arbitrary application of the rules.

Supreme Tax Court judgment I R 45/12 of November 13, 2013 published on March 26, 2014

Schlagwörter

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