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No write-off of amount due from equity investment

The Supreme Tax Court has confirmed that the provision disallowing a debt write-off from a company in which the creditor holds or held over 25% of the shares is to be taken literally.

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The Corporation Tax Act exempts gains on the sale of shares held in other companies. Corresponding losses are disallowed. This disallowance is complemented by a provision disallowing the loss from a bad debt owed by a company in which the creditor holds or held more than 25% of the issued share capital. This bad-debt disallowance applies as of 2009.

A company wrote off an irrecoverable loan due from a company in which it held 24.4% of the share capital. The write-off was recorded in 2008, but the tax office refused to accept it as deductible in that year as the company had made no effort to justify it. The company increased its holding in the debtor to 50% in the following year by buying the (effectively worthless) investment of another shareholder for a nominal amount of €1. The debtor declared bankruptcy shortly after that year-end. The tax office accepted that a bad debt could be substantiated in 2009, but refused to allow a deduction because of the explicit prohibition in the statute. The Supreme Tax Court has now confirmed the tax office in its view, both because of the clear wording of the law and because of the clear legislative intent that the disallowance of capital losses should not be circumvented by substituting loan for equity finance. The court accepted that the effect of the actual provision might be wider than necessary to prevent the abuse at issue, but nonetheless held that that the provision was not, for that reason, invalid. It also accepted that the escape clause allowing a deduction if the creditor could show that a third party would have granted the loan, or allowed it to remain outstanding, in otherwise similar circumstances was difficult to apply in practice. However, this, too, did not invalidate the prohibition or render it constitutionally unreasonable.

Supreme Tax Court judgment I R 87/12 of March 12, 2014 published on June 18

Schlagwörter

bad debt, equity investment