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By PwC Deutschland | 17. März 2017

Write-downs to fair market value resulting from foreign exchange rate differences on investment units are to be added back off-balance sheet

Where a company, which has acquired investment units in US dollar denominated equity funds, writes down the value of the investment units to their fair market value following an unfavourable development in the foreign currency exchange rate, the company must add the write down back off-balance sheet.

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Background

The question before the tax courts was whether foreign currency exchange losses arising from the valuation of investment units could be recognised in calculating the income for corporation tax purposes. The plaintiff (a German limited company – GmbH) had valued the investment units at their lower fair market value as at the balance sheet dates. (This was a permissible treatment.) The company sold the investment units and made a profit in US dollar terms. However, due to the fall in the foreign currency exchange rate, a loss was incurred in Euro terms. The tax office recognised the loss as such, but added it back off-balance sheet according to Section 8b (3) 3rd Sentence Corporation Tax Act. This treatment was confirmed by both the tax court and the Supreme Tax Court.

Reduction of profits arising from write-downs to fair market value are to be neutralised off-balance sheet.

According to Section 8 (2) of the Investment Tax Act the investor's gain arising from the shares during the time of ownership (i.e. the difference between the gain on the shares as at the valuation date and the gain as at the date of acquisition – "pro rata temporis gain") is relevant for the determination of the level of the off-balance sheet add-back. According to the Supreme Tax Court such pro rata temporis loss had been incurred on the shares. Such a reduction in value does not only occur where the stock market price of the shares held by the investment fund goes down, but also where the value of the shares at the balance sheet date has sunk because of a fall in the foreign currency exchange rate. For tax purposes no differentiation is to be made between losses incurred through changes in the stock market price and losses incurred through changes in the foreign currency exchange rates. According to the Supreme Tax Court the purpose of the Investment Tax Act is – following the so-called investment tax law transparency principle - to put investors in funds on a par with direct investors. This should also apply to investments in equity funds. Thus an off-balance sheet add back is also required where the investor decides to write down the value of a fund unit due to a foreign currency exchange loss to ensure an equal tax treatment with direct investors.

Existing symmetry of the rules excludes a breach of EU law

The Supreme Tax Court took the view that the off balance sheet add-back did not amount to a restriction of the EU basic freedoms. The add-back did indeed mean that, ultimately, the foreign currency exchange rate loss was not recognised for tax purposes. However, in the opposite case of an exchange rate gain, which is reflected through a pro rata temporis gain, the law provides for a tax exemption (Section 8 (1) and (3) of the Investment Tax Act and Section 8b (2) Corporation Tax Act).

Reference

Supreme Tax Court decision (I R 63/15) of 21 September 2016, published on 15 February 2017

Schlagwörter

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Corporation tax, Exchange rate losses, Off-balance sheet add backs, Write-down to fair market value