Downloaded from Blogs on 08.11.2026 09:07h

By PwC Deutschland | 29. August 2023

Ministry of Finance: Tax treatment of profit participation rights

On 1 February 2022 the Federal Ministry of Finance (MoF) has sent the draft of a Ministry circular on the income tax treatment of profit participation rights (PPR) to the professional associations for comment. Following the results of the joint meeting of the heads of the corporate and personal income tax departments of the highest tax authorities of the federal states the MoF has published the final version of its circular on 12 April 2023.

Downloaded from Blogs on 08.11.2026 09:07h

Current tax regime

The tax treatment of profit participation rights (PPR) depends on the terms and conditions agreed by the parties involved. According to Sec. 8 (3) Sentence 2 Corporation Tax Act (CTA) distributions of all types on participation rights combining rights to a share in the current profits with the share in the liquidation proceeds of the company do not reduce the taxable income.

However, this view is no longer entirely safe as is evident in the current MoF circular. In addition to the criteria of Sec. 8 (3) Sentence 2 CTA, the tax authorities are now also assessing the equity or debt character of the profit participation certificates. If they are classified as equity capital, distributions cannot be claimed for tax purposes.

For the holder of PPRs, the tax treatment of the profit participation capital is comparable to that of dividends or interest and taxed as investment income (Sec. 20 Income Tax Act) and therefore subject to withholding tax.

The MoF circular

It is noticeably the first time since 1997 that the tax authorities have commented in detail on the question of the tax treatment of profit participation rights. The MoF aims to provide some clarity with regard to the tax treatment of profit participation rights. It also provides more detailed information on the distinction between a profit participation loan and a typical silent partnership.

Except for minor editorial and other structural changes, the final circular is essentially identical to the draft circular sent to the professional associations. In contrast, however, it now explicitly distinguishes whether the holder of the profit participation right is a shareholder or a third party. In the opinion of the MoF, profit participation rights should always and generally be considered as debt if the capital is provided to a corporation by a third party in the context of an agreement for transfer of capital under the law of obligations.

Here is a summary of the main issues addressed in the circular.

Definition

The term "profit participation right" is not legally defined. Therefore, and for the purpose of this circular it comprises creditor rights under the law of obligations, which in principle grant the owner rights which are typically only granted to shareholders. These rights are granted to the creditor in connection with the provision of capital. It follows from this that a PPR agreement must not convey any management rights under the principles of company law.

The provision of capital, even if referred to as PPR, can at most be an indication that a profit participation exists. Due to the freedom of contract, the criteria and principles must be reviewed in each individual case to determine whether a „true“ PPR as discussed in this circular exists.

Typical silent partnership versus PPR

Downloaded from Blogs on 08.11.2026 09:07h

In principle, the silent partner does not participate in the substance and in the liquidation proceeds (Sec. 236 Commercial Code), but he does receive a share in the profits. A typical silent partnership therefore requires the pursuit of a common purpose by the silent partner and the owner of the business, which goes beyond the mere provision of capital.

The existence of a common purpose is evident if, for example, the consent of the investor of the capital is required for a change in business purpose of the company, i.e., being similar to membership rights. Conversely, a clear indication for a PPR would be if no common purpose has been agreed as a result of the capital commitment.

Profit participating loan versus PPR

A characteristic feature of a profit participating loan is that the remuneration for the provision of capital is not, or not only, in a fixed amount on an ongoing (periodic) basis, but rather a share in the earnings generated by the borrower of the loan. A loss participation of the creditor, on the other hand, is unknown to the profit participating loan, and there is also no joint purpose. A sharing in losses and the absence of a joint purpose would therefore be more in favor of a PPR rather than a profit participating loan.

Tax accounting: Distinction between debt capital and equity capital

Irrespective of the reporting of a liability in the balance sheet, remunerations paid on profit participation capital, which constitutes debt capital for tax accounting purposes, are to be treated as business expenses. The limitations for deduction from income as set forth in Section 8 (3) sentence 2 2nd alternative CTA (see above) and the general principles on hidden profit distribution must be examined in a separate step when determining the taxable income.

If capital is provided to a corporation by a third party in the context of a commitment of capital under the law of obligations, it is always considered as debt for tax purposes. If such capital is provided by the shareholder or a person related to the shareholder, a distinction must be made as to whether the capital was transferred to the corporation as debt or equity. Generally, the decisive criteria for confirming the existence of debt capital is an existing repayment obligation.

PPR shown as equity in the commercial balance sheet

Pursuant to the Opinion of the Institute of Public Auditors (IDW/HFA 1/94) PPRs are to be shown as equity if certain criteria are cumulatively met. It is irrelevant if the capital is provided by a shareholder or a third party. This does not prevent a temporary provision of capital (i.e. for a limited period of time) to be qualified as debt for tax purposes.

Profit participation capital in times of crisis

Even if capital is granted during a crisis, it must first be assumed that profit participation capital as defined above generally qualifies as debt. The debtor's insolvency alone does not requalify the PPR as equity capital. The situation may be different if a repayment obligation of the profit participation capital was not

Downloaded from Blogs on 08.11.2026 09:07h

seriously intended and agreed by the parties.

Conversion or option rights

The grant of options by itself does not preclude their classification as debt capital. The qualification as equity therefore generally only occurs from a tax point of view at the time the conversion or option right is exercised but with future effect.

Payments from PPRs and calculation of taxable income

In general, remuneration paid on profit participation capital is a business expense, irrespective of its treatment in the balance sheet. According to Sec. 8 (3) Sentence 2 CTA distributions of all types on participation rights combining rights to a share in the current profits with the share in the liquidation proceeds of the company do not reduce the taxable income.

The term "**participation in profits**" is to be interpreted broadly. It is intended to mean that the profit participation right holder has a share in the economic success of the company issuing the PPRs. The profit participation may be based on key figures such as net income, retained earnings, distributable profit, EBIT and EBITDA. Profit participation is limited by the fact that the maximum amount that can be distributed is the profit reported in the commercial balance sheet. However, there is no participation in profit if the remuneration is dependent on the results of a specific division of the company (tracking stock), individual assets or the results of other group companies. A participation in losses of the corporation is not required.

A **participation in the liquidation proceeds** is to be assumed if, based on the agreements made on occasion of the liquidation of the corporation, the holder of the profit participation right was given a right to at least a partial participation in the hidden reserves in addition to the repayment of the profit participation capital. In contrast, in the case of a profit participation right being limited in time or which may be terminated, there is no participation in the liquidation proceeds within the meaning of Sec. 8 (3) Sentence 2 2nd Alternative CTA if, based on the underlying agreement, there is no participation of the profit participation right holder on occasion of a liquidation of the corporation.

In the case of profit participation capital with a **participation in losses**, a share in the liquidation proceeds also exists if, in the event of liquidation, a claim for repayment of the profit participation capital at least at nominal value was agreed.

Debt-Mezzanine-Swap (DMS)

Note on the concept of a DMS: The DMS is commonly understood as a conversion of liabilities (loans) of a company into so called mezzanine capital by substitution of debt (novation). Mezzanine finance is a collective term for hybrid forms of finance. It has features of both debt and equity. It bridges the gap between debt and equity financing and is subordinate to pure debt but senior to pure equity. The most common forms of mezzanine finance include the subordinated loan, profit participating loan, typical ‘silent’ participation, profit participation rights and convertible bonds.

Downloaded from Blogs on 08.11.2026 09:07h

The MoF‘s comments on DMS:

If a loan receivable is converted into a profit participation right, the tax accounting treatment of the profit participation capital must be examined as a whole on the basis of the principles set out in this letter and in connection with the amended agreement under the law of obligations.

If there is debt capital, the profit participation capital resulting from the conversion must generally be recognized by the corporation as a liability (exchange of liabilities with no profit or loss effect). If, because of the capital transfer, the corporation is not adversely affected economically at the balance sheet date, no liability may be recorded in the balance sheet.

If, on the other hand, a shareholder is granted a profit participation right instead of his original loan receivable, which, according to the principles of this letter, is to be regarded as the placement of equity because of a non-repayment obligation, neither the original loan liability nor a profit participation right liability can be shown in the balance sheet. The reversal of the loan liability results in income which must be realized for tax accounting purposes.

If the ensuing profit is the result of a shareholder relationship, it must be neutralized by recording a capital contribution in the amount of the recoverable portion of the receivables. (Reference is made by the MoF to the Supreme Tax Court judgment 15 April 2015 case no. I R 44/14; more on this judgment **to be found here**).

Application

This letter is to be applied in all open cases. The MoF letter of 27 December 1995 is hereby annulled.

Source:

Federal Ministry of Finance circular of 11 April 2023 (IV C 6 - S 2133/19/10004 :002)

Schlagwörter

profit participating right