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By PwC Deutschland | 18. Dezember 2023

Excess drawings in a two-tier partnership structure

In a decision published on 14 December 2023 on Section 4 (4a) of the German Income Tax Act (restriction of deductible interest expense in the case of excess drawings), the Supreme Tax Court decided that the rule whereby Section 4 (4a) Income Tax Act (ITA) is to be applied for each business in isolation – a so-called business-related application - also applies to multi-level partnership structures. As a result, the transfer of a rolled-over profit in accordance with Section 6b ITA (roll-over relief) to another legal entity does not lead to a contribution to the transferring legal entity - (i.e. a contribution which would reduce the level of excess drawings) - due to the fact that no contributable asset was involved.

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Background

The appellant, a GmbH & Co. KG, held a 94% limited partner interest in Y Land Management GmbH & Co. Object G KG (Y G KG) and Y Land Management GmbH & Co. Object L KG (Y L KG) in the years in dispute 2009 and 2010 respectively. In 2009, the appellant sold its business real estate to Y G KG and Y L KG as part of a sale and leaseback transaction. To partially finance the total investment costs, the limited partner of the appellant (X KG) granted a loan to Y G KG and Y L KG respectively. To refinance these "tenant loans", the appellant granted two loans of the same amount to X KG. The appellant and X KG later cancelled the refinancing loans. When determining the profit declared in its 2009 tax declaration, the appellant opted to roll over the profit of around € 3.6 million realised on the sale of the properties against the acquisition costs of the properties acquired by Y G KG and Y L KG in accordance with Section 6b ITA.

The tax office added back non-deductible interest expenses to the profit declared for 2009 under Section 4 (4a) ITA. The appellant argued that no excess drawings could arise at the level of the subordinate partnerships if the withdrawals and contributions of all related partnerships were considered together. The tax court dismissed the claim.

Decision of the Supreme Tax Court

The appellant's appeal before the Supreme Tax Court was also unsuccessful. Even amongst multi-level partnerships, the Supreme Tax Court saw no room for accepting the appellant’s argument for a cross-business "group-related" calculation of drawings.Contrary to the appellant's view, drawings within a “group” do not lead to a reduction in excess drawings within the meaning of Section 4 (4a) Sentence 2 ITA.

Drawings under Section 4 (4a) ITA are to be defined per business, said the Court, rejecting a final drawings theory. Taking into account both the systematic standpoint and the legislative concept behind Section 4 (4a) ITA - the aim of which is to add back profits in the event of excess drawings being made by a business for which a separate profit calculation has been carried out - the restriction of the interest expense must be considered exclusively per business. If the taxpayer therefore has several businesses or has interests in several partnerships, the interest expense deduction must be determined separately for each business or partnership share. Based on this understanding of the law, according to which the interest expense deduction is primarily linked to the fact that equity is withdrawn from the respective operating unit/business, each transfer of an asset from one of the taxpayer's operating units/businesses to another operating unit/business of the same or another taxpayer generally constitutes a drawing from the transferring business and a contribution to the receiving business within the meaning of Section 4 (4a) Sentence 2 ITA.

The Supreme Tax Court also rejected the appellant’s argument about the effect of the transfer of the rolled-over profit under Section 6b ITA on the calculation of excess drawings, as there was no contribution of an asset in this case.

Reference

Supreme Tax Court, judgement of 27 September 2023 (IV R 8/21) - published on 14 December 2023.

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Schlagwörter

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