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By PwC Deutschland | 01. Juli 2024

Constitutionality of the loss set-off restriction for forward transactions

In the summary review required during suspension proceedings under Section 69 (3) of the German Tax Court Code, the loss set-off restriction for forward transactions/futures under Section 20 (6) Sentence 5 of the German Income Tax Act (ITA) in the version of the Finance Act 2020 of 21 December 2020 (Federal Law Gazette I 2020, 3096) is incompatible with Article 3 (1) of the German Constitution. This was decided by the Supreme Tax Court in a ruling published on 27 June 2024.

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Background

The applicants, who were subject to unlimited tax liability and were jointly assessed to income tax in the year 2021 (year in dispute), have challenged the restriction on loss set-off for forward transactions/futures under Section 20 (6) Sentence 5 ITA) in the version of the Finance Act 2020. They consider the provision to be unconstitutional.

The Rhineland-Palatinate Tax Court granted the application for a stay of execution due to significant constitutional concerns regarding the compatibility of the restriction on loss set-off under Section 20 (6) sentence 5 ITA (Finance Act 2020 version) with Article 3 (1) of the German Constitution. The legality of the contested income tax assessment for the year in dispute was seriously in doubt.

Decision of the Supreme Tax Court

The Supreme Tax Court agreed with the decision of the lower court and dismissed the appeal as unfounded.

The tax court rightly suspended the execution of the contested income tax assessment for the year in dispute. In its summary review, the Supreme Tax Court considered the restriction on loss set-off for forward transactions/futures under Section 20 (6) Sentence 5 ITA (Finance Act 2020 version) to be incompatible with Article 3 (1) of the Constitution.

Section 20 (6) sentence 5 ITA gives rise to a two-fold unequal treatment of taxpayers who realise losses from forward transactions.

The separate set-off group for losses from forward transactions/futures leads to unequal treatment between taxpayers who have realised losses from forward transactions and those who have realised losses from other investments. Further within this separate loss set-off group, there is also an unequal treatment of gains and losses from forward transactions realised by the taxpayer.

The Supreme Tax Court stated that - within the introduction of the additional loss set-off group in Section 20 (6) Sentence 5 ITA – it was not able to recognise a system change by the legislator away from the basic principle – already regulated in Section 20 (6) Sentence 2 ITA - of equal treatment of positive and negative investment income taxed at a separate special rate.

The Court’s summary examination gave rise to the conclusion that there were no sufficient reasons to objectively justify this double unequal treatment.

Source:

Supreme Tax Court, decision of 7 June 2024 (VIII B 113/23 (AdV)), published on 27 June 2024.

Schlagwörter

Futures, Income Tax Act, loss curtailment, losses