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By PwC Deutschland | 07. Februar 2025

Waiver of loan by shareholder of a corporation in return for debtor warrant

One of the issues of dispute before the tax courts was if the waiver of a claim by a shareholder of a corporation in return for a debtor warrant should be taken into account at the time of the waiver or later if it is certain that the condition subsequent will no longer occur. According to the decision of the Supreme Tax Court, the ensuing loss in the case from the waiver is to be considered for tax purposes already at the time of the waiver. This results in negative income from capital investments in the amount of the non-recoverable receivable. The Supreme Tax Court further revealed on how it sees qualified subordinated debt and interest for refinancing of the loan to be treated in the hands of a shareholding managing director.

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Background

In **2009 (year of dispute)**, the plaintiff held a 1% share in a limited partnership (KG). The company later ran into financial difficulties. Together with other shareholders, the plaintiff granted the KG a subordinated loan with an interest rate of 4.5% without any collateral. To refinance the loan, the plaintiff himself took out an interest-bearing loan from a bank at a variable interest rate.

Following a shareholder resolution, the KG was restructured into a private limited liability company (GmbH) in 2009 in which the plaintiff then held a corresponding share. After the financial situation of the GmbH had deteriorated further by the end of 2009, the shareholders waived their claims under the loan agreements. The waiver included the right to repayment of the loan amounts but did not include the interest claims already accrued. The waiver was subject to the condition subsequent that the company would be in a financial position to repay all loans in full of retained earnings (debtor warrant).

In his 2009 income tax return and based on the loan waiver, the plaintiff claimed the ensuing loss as deductible **expense from his employment income**. The tax office did not agree and classified the loan waiver as a hidden contribution. In addition, the plaintiff declared the interest from the refinancing loan as negative investment income **for 2011**. However, the tax office only took 60% of the corresponding income into account under the partial income method.

The Munich Tax Court partially upheld the claim. Inasmuch as the loss from the waiver of the loan repayment had not been taken into account as income-related expenses in the income from employment the appeal was unfounded. Income-related expenses must be deducted from the type of income from which they incurred. Where an employee grants a loan to generate interest income from capital investment is usually the primary source of income. After taking a look at the overall circumstances, the court of first instance was unable to conclude that the loan had been granted primarily for reasons of the plaintiff’s employment.

The appeal for recognition of the refinancing interest paid in 2011 was unfounded. The tax office had been correct to only allow a 60% deduction within the scope of the partial income method as the loan was not primarily caused through the activity as managing director.

Decision

The Supreme Tax Court fully agreed with the decision of the Munich Tax Court and rejected the tax office's appeal.

The loss from a debt waiver subject to the condition subsequent (against a debtor warrant) must be taken into account already at the time of the waiver and not at a later time when it is certain that the condition subsequent will no longer occur. The tax office's

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view that the legal tax consequences of the conditional waiver should only be taken into account if and when it is certain that the condition will no longer occur was not acceptable to the Supreme Tax Court.

It is true that the loss from the default of a loan only arises when it is certain that payment can no longer be expected. However, a waiver subject to a debtor warrant cannot be regarded in the same way as a default. While the forfeiture of a receivable can be a continuous development until its final default, a waiver is a one-time event where the legal effects occur immediately and without delay as a result of the taxpayer's disposal.

The plaintiff's debt waiver did not lead to deductible income-related expenses resulting from his employment. The actual findings of the tax court of first instance, according to which both the grant of the loan to the KG and its subsequent waiver to the GmbH after the change of legal form were primarily caused by the shareholder relationship, was confirmed by the Supreme Tax Court.

With the waiver of the debt the plaintiff incurred a taxable loss in the amount of that part of the loan that was no longer recoverable at the time of the waiver. This loss is to be taken into account in the year of dispute and by no means irrelevant for want of the intention to generate income. The intention to generate income is rebuttably presumed under the flat rate taxation scheme. The presumption is not refuted in the case in dispute. Neither the generation of positive net interest income was ruled out from the outset nor was it ruled out that the plaintiff could generate positive investment income or a capital gain from the KG or the GmbH in the medium to long term.

Section 20 (8) Sentence 1 Income Tax Act (ITA) does not prevent the loss from being taken into account. This provision only applies insofar as the income in question is not part of income from business operations. However, income from business operations also includes income within the meaning of Section 17 ITA (1) Sentence ITA which specifies that “income from business operations also includes the profit from the sale of shares in a corporation if the seller has directly or indirectly held at least 1 percent of the company's capital within the last five years.“.

Section 20 (2) ITA (listing the taxable events to be taken as investment income) is only superseded by Section 17 ITA if and to the extent that the loss has affected the calculation of income under Section 17 ITA in the period to be assessed. This requires, in particular, that the circumstances laid down in Section 20 (2) ITA (…) are realized in the same assessment period. In consequence, Section 20 (2) ITA was applicable here because according to the findings of the lower tax court, the plaintiff did not sell his shareholding in the GmbH in the year of dispute and the GmbH was also not dissolved in the year of dispute.

Source:

Supreme Tax Court judgment of 19 November 2024 (VIII R 8/22) – published on 6

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February 2025.

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losses, waiver