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By PwC Deutschland | 16. November 2026

Deduction of interest on debt pursuant to Section 4(4a) of the Income Tax Act following the conversion of a corporation into a partnership – treatment of the positive equity taken over as a capital contribution

A corporation’s conversion into a partnership raises an important question under Section 4(4a) of the German Income Tax Act (ITA): does the positive equity taken over count as a contribution when calculating excess withdrawals? The Supreme Tax Court confirmed that it does. It also reaffirmed that the provision applies to lower-tier partnerships even where no natural person holds a partnership interest.

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Background to the dispute

The claimant, a GmbH & Co. KG, was formed through R-GmbH's change of legal form under Section 9 of the Reorganisations Tax Act (RTA), effective 1 January 2010. R-GmbH's shareholder, S-GmbH & Co. KG (S-KG), became the claimant's sole limited partner with a capital interest; R-Verwaltungs GmbH became its general partner. S-KG's sole partner with a capital interest was S-SE & Co. KG.

Following a tax audit, the tax office calculated excess withdrawals for 2012 using an opening balance of €0.00 as at 1 January 2010. Based on the interest actually incurred and Section 4(4a), sentences 4 and 5, ITA, this produced an additional amount of €52,082.20.

The claimant challenged the tax office' s refusal of its administrative appeal in an appeal to the lower tax court. The tax court upheld the claim in full. The tax office appealed, seeking to have the judgment set aside entirely and the claim dismissed.

How the interest limitation works

Section 4(4a) ITA limits the deduction of debt interest where partner withdrawals exceed the financial year's profits and contributions. Non-deductible interest is calculated at 6% of current excess withdrawals, increased by previous years' excess withdrawals and reduced by previous years' under-withdrawals. Profit is calculated before this interest adjustment. The add-back is capped at the actual interest incurred during the year less €2,050. The provision also applies when determining trade income under Section 7 of the Trade Tax Act.

Multi-tier partnerships: a business-specific approach

The Supreme Tax Court confirmed that Section 4(4a) ITA applies at the level of each partnership, regardless of its partners' legal forms. Its judgment of 27 September 2023, IV R 8/21 had already treated a parent partnership's withdrawal of profits from a lower-tier partnership as a withdrawal under the provision, although the latter's partners were a GmbH and a KG.

The decisive unit is the individual business for which profits are separately determined, not the group as a whole. A withdrawal is a reduction in equity for non-business purposes within Section 4(1), second sentence, ITA. Assessing transfers across an entire group would conflict with both this business-specific approach and the legislature's aim of simplifying the interest adjustment.

It is therefore irrelevant whether the partners have a private sphere or whether there is evidence of abusive financing. Although preventing abuse motivated the legislation, its operation depends on withdrawals from the relevant business, rather than individual private transactions.

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Why positive equity counts as a contribution

The Court agreed that R-GmbH's positive tax-balance-sheet equity, taken over as at 1 January 2010, must be treated as a contribution under Section 4(4a), second sentence, ITA. Admittedly the change of form does not constitute a contribution within the express literal meaning of section 4(1), eighth sentence, ITA. However, in accordance with the spirit and purpose of Section 4(4a) ITA, the positive (tax balance sheet) equity of R-GmbH taken over by the claimant on 1 January 2010 is to be treated as a contribution

The structure of the provision is based on the equity model and the principle that, where equity is negative, the business owner may not withdraw more funds from the business than he has generated and contributed. Through the terms 'withdrawal', 'profit' and 'contribution', the provision – just as with the rules on offsetting these amounts and carrying them forward across accounting periods – is linked to the development of equity. Furthermore, the systematic position and legislative design of Section 4(4a) ITA are aimed at adding profits to the tax base where excessive withdrawals occur in the business for which a separate profit calculation is carried out. The reduction in deductible interest is therefore primarily linked to the fact that equity has been withdrawn from the relevant business entity and must therefore be interpreted on a business-by-business basis. Accordingly, in principle, any transfer or conveyance of an asset from the taxpayer's business operations to another part of the same taxpayer's business operations or to those of another taxpayer constitutes a withdrawal from the transferring business and a contribution to the receiving business within the meaning of Section 4(4a), second sentence ITA.

Such a transfer is also to be assumed for the purposes of section 4(4a) ITA in the case of a change of legal form pursuant to section 9 of the Reorganisations Tax Act (RTA).

In the case of a change of legal form, the tax law on conversions – by virtue of the reference in Section 9, first sentence, RTA to Sections 3 to 8 and 10 RTA – assumes a transfer of assets - in contrast to the civil law on reorganisations. For tax purposes, the assets of the transferring corporation are transferred to the acquiring partnership. This transfer of assets is deemed to have taken place due to the different tax regimes applicable to corporations and partnerships.

This deemed transfer of assets justifies the assumption of a contribution within the meaning of Section 4(4a), second sentence, ITA. This is because, the two businesses – that of the corporation and that of the partnership – are to be regarded as separate businesses for the purposes of Section 4(4a) ITA. Consequently, the assets representing the corporation's positive equity are contributed to the partnership.

This interpretation of the law is consistent with the spirit and purpose of section 4(4a) of the ITA. The structure of the provision is based on the equity model. Equity constitutes the limit on the amount of funds that the business owner may withdraw from the business without triggering the legal consequences of section 4(4a) ITA. Equity is increased by profits and contributions; it is reduced by withdrawals and losses. In the event of a change of legal form, the deemed transfer of assets results in a cross-business transfer of equity and thus, for the purposes of Section 4(4a) ITA, in a transaction that is, at the very least, similar to a capital contribution.

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Furthermore, a change of form cannot be treated differently from the commencement of a business. When a business begins operations, its initial funding counts as a contribution, even where the transaction is merely contribution-like, as reflected in Section 6(1)(6) and (5) ITA. A conversion under Section 9 RTA warrants equivalent treatment. Section 9, second sentence, reinforces this analogy by requiring the partnership to prepare a tax opening balance sheet at the conversion's effective date.

Why tax succession ("Rechtsnachfolge") does not change the result

The tax office argued that the situation was similar to cases in which excess or under-withdrawal balances pass to a successor, such as gratuitous transfers of businesses or partnership interests under Section 6(3) ITA, and book-value contributions of sole-trader businesses in exchange for partnership rights under Section 24 RTA. The Supreme Tax Court accepted this argument in principle but distinguished it from a change of form.

Although the partnership assumes the corporation's tax position under Section 9, first sentence, together with Section 4(2), first sentence, RTA, Section 4(4a) ITA does not apply to corporations. They therefore have no excess or under-withdrawal balances to transfer—not even a balance of €0. The principle of tax succession cannot transmit a tax position that never existed.

Source:

Supreme Tax Court judgment (IV R 10/24) of 2 September 2026, published on 12 November 2026.

Schlagwörter

Reorganisation Tax Act, partner withdrawals