By PwC Deutschland | 10 July 2013

Write-down on some foreign investments permitted for 2001

The Supreme Tax Court has held that the Corporation Tax Act prohibition on impairment write-downs on foreign investments in 2001 must be disapplied if the investment is protected by the EU freedoms of establishment or capital movement, or if it leads to retrospective taxation.

In 2000 the corporation tax system changed radically from the imputation/split-rate procedure to the present part-charge/single rate system. In both cases, the idea is to tax corporate income only once, at a burden the ultimate shareholder could expect to bear, had he received the income directly. The achievement of this object depended under the old system upon a lack of foreign income taxable abroad and under the new system upon an accurate reflection in the ratios set by the tax acts of the facts in the given circumstances. This desired result is, and was, seldom, if ever, achieved.

In an effort to keep changeover difficulties to a minimum, the Corporation Tax Act provided that annual profits in 2000 be taxed under the old system, whilst those earned in 2001 fall under the new. At the same time the tax deduction for impairment write-downs on investments was withdrawn. This withdrawal took effect as of 2002 for domestic investments but as of 2001 for foreign investments. The ECJ has already held that a distinction in the tax treatment of domestic and foreign investments can be seen as a restriction on the freedoms of establishment or capital movement (case C-377/07 *STEKE*, judgment of January 22, 2009) and doubts have also been raised as to the validity of the prohibition for 2001 in the light of the constitutional ban on taxation in retrospect. The Supreme Tax Court has now been called upon to examine these principles when applied to the write-down of a significant investment in a US subsidiary in the annual accounts at September 30, 2001.

The investment in the US subsidiary amounted to 97.7%. The US double tax treaty sets the level of a significant holding for dividend withholding tax privileges at 10% and this value could be taken as the minimum necessary to secure significant influence over the management of the company. Accordingly, the relevant EU freedom in the present case was that of establishment, rather than that of capital movement. Since the freedom of establishment does not apply outside the EEA, it does not apply to a US investment. Accordingly the denial of the tax deduction on the write-down on the US investment at issue did not offend against community law.

According to the letter of the statute, the tax deduction was withdrawn in respect of foreign investments for all business years ending after August 15, 2001. The withdrawal was debated in a bill laid before the *Bundestag* on September 9, 2001. A write-down for value impairment was a decision to be taken as of the balance sheet date based on the then circumstances. Thus there could be no question of retroactive legislation in respect of any write-down in an annual balance sheet drawn up after September 9. This applied in the present case of a write-down taken in the accounts as of September 30, 2001.

Supreme Tax Court judgment I R 10/11 of March 6, 2013, published on July 10

Keywords

Wertminderung / Impairment (allgemein), foreign investment, write-down