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Gain on sale of profit participating right acquired before 2009 tax-free

The Supreme Tax Court has held that gains from the sale of profit participating rights acquired up to December 31, 2008 are to be tax-free under the continued application of old law.

Up to December 31, 2008, interest and chargeable dividends were subject to mainstream income tax as was any chargeable gain on the sale of an investment. However, gains from the sale of investments were only chargeable if the investment was held as a business asset, it was part of a holding of at least 1% in the equity of the company, or if it had been held for less than a year (short-term gains). As of January 1, 2009, the law was changed to the effect that all gains on the sale of shares or other securities were classified as investment income and all investment income was taxed at a flat rate of 25%. Changeover provisions held that existing investments on January 1, 2009 should not lose their status, i.e. gains from their sale would continue to be tax-free if exemption would have been available under old law. These changeover provisions were then circumscribed slightly in an attempt to exclude financial innovations from their effect. This led to a dispute between a taxpayer and his tax office as to whether or not a gain from the sale of a profit participation right acquired before 2009 should enjoy the exemption that it would have had on December 31, 2008.

The Supreme Tax Court found that the wording of the statute was not entirely clear. However, if referred to the official explanation attached to the amending bill which explicitly stated that it was not the intention to “catch” previously existing profit participating rights. This was sufficient authority for the Supreme Tax Court to hold that profit participating rights that did not allow the holder to share in a liquidation surplus of the company should continue to be treated as profit-sharing loans, that is, a gain from the sale of those arising on or before December 31, 2008 and held as private assets should continue to enjoy its exemption under old law.

Supreme Tax Court judgment I R 27/12 of December 12, 2012, published on August 14, 2013

Keywords

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