Downloaded from Blogs on 03.11.2026 06:12

By PwC Deutschland | 26 February 2015

No refusal of related-party loan write-down for lack of security

The Supreme Tax Court has rejected a tax office income adjustment cancelling a write-down of an unsecured loan to a foreign subsidiary as the lack of security was, in the view of the tax office, not at arm’s length.

Downloaded from Blogs on 03.11.2026 06:12

A German parent financed its loss-making US subsidiary with a series of loans. The loans were interest bearing, but were unsecured. The parent wrote these loans down in the year of grant because it saw their repayment as doubtful (the present prohibition on deduction of related-party bad debts was not yet in force). The tax office accepted the doubt but added the expense back to income under the arm's length income adjustment provision of the Foreign Tax Act. Its reasoning was that the loans had not been granted at arm's length as a third party would have insisted on security, given the debtor's precarious position.

The Supreme Tax Court has now rejected the tax office' view. The parties to a loan within a group of companies was subject to the presumption of mutual support between group members. On this presumption, an unsecured loan could be granted to a financially frail subsidiary without breach of the arm's length principle, even if there was no uplift to the interest rate to reflect the risk of default. However, this finding did not mean that the company had won its case. Rather, the Supreme Tax Court referred the case back to the lower court for further investigation of the facts. The lower court should clarify the possibility of the loans' having been granted as equity substitutes, as, in that case, they would rank as investments and fall under the consequent prohibition on deductions of losses from sale, disposal or write-down. The court should also look further at the context of the group support. As long as that support remained available, no debt write-down could be taken to expense for the same reason that no interest uplift could be demanded for increased credit risk.

Supreme Tax Court judgment I R 23/13 of December 12, 2014 published on February 25, 2015

Keywords

foreign subsidiaries, unsecured loan, write-down