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By PwC Deutschland | 26 August 2016

No trade tax loss carry-forward with merger of two-tier partnership

In its decision of 12 May 2016 the Supreme Tax Court held that -in the case of a two-tier partnership structure- the trade tax loss carry-forward of the lower-tier partnership is fully eliminated, if the upper-tier partnership, which holds a 100% -interest in the income and assets of the lower-tier partnership, is merged down-stream and thus ceases to exist. Referring to previous case law, the Court’s reasoning was that the upper-tier partnership, as co-entrepreneur of the lower-tier partnership, was also the holder of the partnership’s trade tax loss-relief.

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B and C were limited partners in the upper-tier partnership, A-KG, with a 100% interest in its income and assets; the general partner, a limited company, D-GmbH, held a 0% interest in its income and assets. In turn, A KG, the upper-tier partnership, as limited partner, held a 100% interest in the income and assets of the lower-tier partnership, the appellant in this case; the general partner, A-GmbH, in the appellant also held a 0% interest in its income and assets.

As a result of C's withdrawal from the upper-tier partnership on 2 January 2001, his interest in the upper-tier partnership accrued to B. On 3 January 2001, B sold his interest in the upper-tier partnership to a limited company, E-GmbH.

By a contract dated 6 June 2002, the upper-tier partnership was merged down-stream into the lower-tier partnership. For tax purposes, the merger was deemed to have taken place in 1 January 2002; the upper-tier partnership's balance sheet to 31 December 2001 acted as the basis.

Following the merger, D-GmbH, the former general partner of the upper-tier partnership became a general partner of the lower-tier partnership, together with its former general partner, A-GmbH. As in the previous constellation, neither general partner held an interest in the income and assets of the lower-tier partnership; post-merger; E-GmbH held the 100% interest.

For the years 2001-2003, the tax authorities had assessed a trade tax loss carry-forward for the lower-tier partnership. Following a tax audit, the trade tax loss carry-forward was deleted with effect from 31 December 2001. The tax court confirmed the loss deletion, the appellant appealed to the Supreme Tax Court.

Upholding the decision of the lower court, the Supreme Tax Court stated that the assessment of a trade tax loss carry-forward at the end of a period of assessment, presupposes that such losses still exist. In the case of a partnership, this will no longer be the position, where the trade tax losses have been deleted because the holder of the losses has either withdrawn from the partnership or has been dissolved.

In the case of a two-tier partnership, the upper-tier partnership is not only a partner but also a co-entrepreneur of the lower-tier partnership, i.e. it is "entrepreneurially" involved in the lower-tier partnership, and thus the *holder* of the loss carry-forward. On the one hand this means that a change in the partners of the upper-tier partnership does not effect the identity of the entrepreneurship of the lower-tier partnership. On the other hand, it follows that the trade tax loss carry-forward is (partially) deleted, if the partners of the upper-tier partnership become the direct partners of the lower-tier partnership, due to extinction of the former through the unification of the partnership interests.

An important point here was that the upper-tier partnership was the holder of the trade tax loss carry-forward as it held a 100% interest in the income and assets of the lower-tier partnership, whereas the latter's general partner held a 0% interest.

Supreme Tax Court decision of 12 May 2016 (IV R 29/13 - NV) published on August 24

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