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By PwC Deutschland | 16 May 2017

Curtailment of loss relief for companies in part unconstitutional

The German Constitutional Court held that the rules for curtailment of loss relief on change of shareholders to be in breach of the formal provisions of the constitution under the principle of equal treatment insofar as changes of more than 25% and up to 50% of the shares in a company within a period of five years are concerned.

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Background: Curtailment of loss relief on changes of shareholder

The rules for the curtailment of loss relief on changes of shareholder in Sec. 8c Corporation Tax Act (CTA) were introduced for years from 2008. Basically, loss carry forwards are to cease if more than 50% of the shares in the loss making company are directly or indirectly acquired by a single acquirer or his related party over a period of five years. If more than 25% but no more than 50% are transferred in this way, the loss carry forward is reduced in proportion to the transfer. Two exceptions were introduced from 1 January 2010: The first provided for the preservation of loss carry forwards on certain group internal reorganizations and the second to protect them up to the level of the hidden reserves of the company.

On 23 December 2016 the Act for the Further Development of Tax Loss Utilisation for Corporations was published whereby the government modified the existing curtailment of loss relief on changes of shareholders by introducing a new Sec. 8d CTA with (retroactive) effect from 1 January 2016. According to new Sec. 8d CTA the loss curtailment rules of Sec. 8c CTA do not come into play where the business operation does not change (this, however, to be subject to further conditions). For more details of these amendments please visit our **Tax & Legal** site.

Constitutional Court: Discriminating treatment of corporations

The relevant Sec. 8c sub-sec. 1 sentence 1 CTA dealing with changes of more than 25% and up to 50% of the shares in a company within a period of five years is unconstitutional. According to the Constitutional Court there is no justification for the unequal (different) treatment of companies in cases of a harmful change of ownership, i. e. where more than 25% but no more than 50% are transferred and where the loss carry forward is then reduced in proportion to the transfer. The court sees no plausible reason to assume a (harmful) change of identity of the company without taking further into account the business assets and / or the type of business of the company. The court left it open whether this should be judged differently in situations where more than 50% of the shares are transferred. If, following the introduction of new Sec. 8d CTA from January 2016, Sec. 8c CTA would thereafter meet the contitutional requirements remains to be seen and should be subject to a separate review.

Since the plaintiff in the case at hand was a limited company (GmbH) the court did not have to elaborate on other situations, namely if and to what extent the loss curtailment rules would apply to other corporations and to certain other transfers.

The Constitutional Court finally held that the present rules for loss relief in case of change of shareholding of more than 25% up to 50% be amended by December 31, 2018 and with retroactive effect from 1 January 2008 and until 31 December 2015. If the legislators do not comply with this obligation the relevant Sec. 8c sub-sec. 1 sentence 1 CTA would be held imcompatible and invalid retroactive from 1 January 2008.

Constitutional Court resolution *2 BvL 6/11* of March 29, 2017; official press release of May 12, 2017

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Keywords

Loss relief, change of shareholders, curtailment of losses