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By PwC Deutschland | 05 December 2017

Final circular published by Federal Ministry of Finance on application of loss forfeiture rules

On 30 November 2017, the Federal Ministry of Finance published the final version of its circular on the application of the loss forfeiture rules according to Section 8c of the Corporation Tax Act (CTA), including comments on the Hidden Reserve Clause and the Group Clause. This circular replaces the circular on this subject from 4 July 2008.

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In addition to reflecting new case law and making some editorial adjustments the new Finance Ministry circular of 28 November 2017 addresses for the first time questions on matters such as harmful share acquisitions during the financial year, the Group Clause and the Hidden Reserve Clause.

Harmful share acquisitions during the financial year

The tax administration has now adopted the 2011 decision of the Supreme Tax Court on share acquisitions occurring during the financial year, according to which available losses may be set off against profits arising in the period before the harmful share acquisition. The available loss carry-forward assessed at the end of the previous period of assessment can be set off against positive total income attributable to the period up to the date of the harmful share acquisition. The result for the whole of the financial year must, however, be allocated according to economic criteria. (This also applies to financial years which do not correspond to the calendar year.) Examples of suitable allocation criteria would be the preparation of an interim balance sheet to the effective date or an objective and economically-reasoned estimate. Where the prior year loss carry-forward - available for set-off under the said allocation - cannot be fully utilised in the year of the harmful share acquisition because of the minimum taxation rules, the remaining loss will be carried forward. For tax consolidation groups (Organschaft), the loss carry-forward restriction resulting from a harmful share acquisition during the financial year is to be applied separately at the level of the controlling company and at the level of the subsidiary.

Group Clause

The tax administration assumes here that the terms “transferring entity” and “receiving entity” used in § 8c (1) 5th Sentence CTA are specific to that provision and are not to be interpreted according to the meanings applied in the provisions applicable to tax reorganisations. Despite the use of the terms “vendor” and “purchaser” in the text of the provision, the Group Clause should be applicable to all legal transactions which could lead to a harmful share acquisition, including, for example, gifts or hidden contributions.

The conditions of the Group Clause will be met where the purchaser holds a (direct or indirect) 100% interest in the transferring entity or the vendor holds a (direct or indirect) 100% interest in the receiving entity or the same person holds a (direct or indirect) 100% interest in both the transferring and the receiving entities, even when a third party also holds an interest in the company with the losses.

Hidden Reserve Clause

Following a harmful acquisition of shares, losses will still remain deductible to the extent that they do not exceed the hidden reserves attributable to the business assets of the company with the losses; the relevant assets here must fall within the German tax net. Hidden reserves attributable to shareholdings will not be included in the calculation, where the gain arising from the disposal of such a shareholding would not be subject to tax under Section 8b (2) CTA. The fact that 5% of the gain is treated as a non-deductible business expense and is taxed will have no impact here.

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In cases of multi-tiered shareholdings the conditions of the Hidden Reserve Clause must generally be examined at the level of each company with losses. This also applies where the business assets of the company with losses contain one or more holdings in a tax consolidation group subsidiary. In the view of the tax administration, hidden reserves in the business assets of a tax consolidation group subsidiary are not to be considered at the level of the controlling company.

Impact of the decision of the Constitutional Court on 29 March 2017

With regard to the decision of the Constitutional Court (2 BvL 6/11) of 29 March 2017, in which the partial forfeiture of loss carry-forwards where more than 25 per cent but not more than 50 per cent of the shares changed ownership was held unconstitutional, the relevant rule in Section 8 c 1st Sentence CTA / Section 8 c (1) 1st Sentence CTA) is not to be applied to direct acquisitions of shares in companies before 1 January 2016 until a new provision is introduced. However, in relation to indirect share acquisitions, the circular does not exclude the further application of the rule pending new legislation.

Analogous application of the principles of the Finance Ministry circular to trade tax

Section 10 a 10th Sentence Trade Tax Act (TTA) provides for the application of Section 8 c CTA to trade tax. According to the ordinance on this matter of 29 November 2017 issued by the higher tax authorities of the Federal States, the principles of the Finance Ministry circular of 28 November 2017 shall apply without restriction to trade tax. The ordinance further stipulates that hidden reserves at the level of a partnership, in which the company has an interest, cannot be taken into account in the application of Section 10 a 10th Sentence TTA.

Keywords

group clause, harmful share acquisition, hidden reserve clause, loss forfeiture, share acquisition