

By PwC Deutschland | 28 January 2019

Distinction between the interruption of a business and its termination

In its judgment of 18 July 2018 published on 23 July 2019, the Supreme Tax Court decided that, where – looking at the situation from an objective point of view - it would be possible for the taxpayer to continue his business, it should be considered as interrupted rather than terminated.

Furthermore, the Court held that the taxpayer could not submit a termination declaration and retain the business infrastructure without making any significant changes.

Background

In 2003 the appellant established both a property developing business in the form of a sole trade and a building business in the form of a limited company (GmbH) of which he was the sole shareholder. In 2005, the appellant leased all the net assets of the property development business (i.e. the sole trade) to the GmbH; shares in the GmbH were recorded for the first time in the balance sheet of the sole trade as at 31 December 2007. In the year to 31 December 2008, the leased assets were sold to the GmbH. The tax office took the view that the lease of the assets in 2005 constituted a business split (i.e. after the split the sole trade comprised a property development business activity and a leasing business activity). In turn, the sale of the assets to the GmbH led to a termination of the business split and thus a termination of the sole trading business. This termination of the sole trading business, so the view of the tax office, resulted in a transfer of the GmbH shares into the private property of the appellant and thus a gain on the business disposal.

The tax court refused the appeal on the basis that the sole trading business was not made up of two separate operating businesses units but rather two non-independent fields of activity. The appellant had carried on the business as a single entity. The Supreme Tax Court rejected the decision of the tax court and referred it back, on the basis that the tax court had not reached a decision on whether the appellant had actually closed down the property development business over a longer period of time. The questions about existence of a business split and whether an objective interdependence had been brought to an end, were not relevant to issue before the court.

Furthermore, the tax court had applied the wrong legal principles (i) when assessing under what conditions it would be possible for a business with two commercial operations to be reinstated after it had been interrupted and (ii) when reviewing the question of the existence of separate operating business units.

The decision

The tax court had taken the view that the sale of the assets by the sole trading business resulted in a cancellation of the leasing business activity, and a discontinuance of the property development activity. The Supreme Tax Court took the view that in such a case, the proper question was whether a resumption of the activity was objectively possible. In this regard, however, the Court noted that the taxpayer could not freely choose to keep treating the assets as business assets forever and a day.

The Supreme Tax Court did not accept the tax court's view that a future reinstatement of the business was only possible if the future business was identical to the businesses operating up until the end of 2008. It was sufficient if one of the previous activities were reinstated. The proper question was whether the interruption was temporary. The Court did not define what was meant by "temporary" (i.e. put a time limit on it), merely referring to the circumstances of the individual case.

With regard to the definition of separate operating business units, the Court considered the tax court placed

too much emphasis on the fact that the businesses operated through a single organisation – i.e. a single office, with joint bookkeeping, joint personnel and joint administration. In assessing whether separate operating business units existed it was necessary consider the situation as a whole; the fact that in the instant case the operating units only operated through a single organisation was less relevant in comparison to other issues because one of the operating units only required minimal organisational input.

Source: Supreme Tax Court decision *X R 36/17 NV* of 18 July 2018, published on 23 January 2019

Keywords

business closure, business unit, separate operating business units, suspension of trading, termination of trading