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Loss on exchange of profit participation rights can be offset against investment income

The Regional Tax Court of Muenster held that a loss from the exchange of profit participation rights for shares in a registered cooperative ("eG") and bonds may be set off against income from capital investments. Thus, the tax office's attempt to regard the loss as belonging to the non-taxable private asset portfolio of the plaintiff failed.

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Facts of the case

The plaintiff was the owner of profit participation rights (PPRs) in a GmbH. In the wake of insolvency proceedings filed over the assets of the GmbH the latter was converted into a registered cooperative (eG) in accordance with an insolvency plan, and the plaintiff in turn received cooperative shares, bonds, and a fractional compensation for his previous PPRs.

The plaintiff declared a loss from this conversion (exchange) in shares, which he claimed in his income tax return. This was not accepted by the tax office: The loss of the portion of the receivables not repaid was disregarded for income tax purposes as being attributable to the non-taxable and purely private asset sphere of the plaintiff.

Decision

The Regional Tax Court held that the loss had to be recognized for tax purposes because the PPRs are regarded as other capital claims and thus any income/loss therefrom to be viewed as the “the disposal of other capital receivable of any kind” as set forth in Sec. 20 (2) sent. 1 no. 7 Income Tax Act (ITA). As the PPRs did not grant the holder any right to liquidation profits, they did not qualify as a regular shareholding in the GmbH. The surrender of the PPRs in return for cooperative shares and bonds was an exchange transaction equivalent to a sale within the meaning of Sec. 20 (2) sent. 1 no. 7 ITA. The calculated amount of loss (which itself was not in dispute) arose while deducting the acquisition costs of the PPRs from the "exchange proceeds".

The court went on to say that losses from capital investments that are subject to capital gains tax may, on the other hand, only be offset or reduce the income that the taxpayer earns from capital assets in subsequent assessment periods if a certificate in an officially prescribed form within the meaning of Section 43a (3) sent. 4 ITA is presented, which must be issued by the payment center for the investment income. However, the loss can still be offset in the case of dispute, as no such payment center exists in the case of publicly traded negotiable PPRs. Under the specific conditions of the PPRs, they were in principle freely transferable, its holders were only obliged to inform the GmbH of name, address, and bank account of the new holder of the PPRs within four weeks of the transfer. Accordingly, it would have been impossible for the GmbH to fulfill any of the obligations of a regular payment center as prescribed in Sec. 43a ITA.

Source:

Regional Tax Court of Muenster, decision of 9 June 2021 (case ref. 13 K 207/18 E,F).

Keywords

capital investment income, exchange gain or loss, loss offset, profit participation rights