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By PwC Deutschland | 16 February 2023

Tax consolidation group in case of insolvency

The profit pooling agreement under the concept of a tax consolidation group (Organschaft) must be concluded for at least five years and be followed throughout its entire term. According to the decision of the Supreme Tax Court recognition of the Organschaft is to be denied with retroactive effect if preliminary annual financial statements of the controlled company can no longer be adjusted due to insolvency and if a different result would have been reported in the final annual financial statements if the accounting principles under commercial law had been applied correctly.

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Background

The dispute is whether the insolvency of both parties to a profit and loss transfer agreement (PTA) prior to the expiry of the five-year minimum term of the agreement leads to the retroactive denial of the group taxation (*Organschaft*) for income tax purposes (corporation profits tax and trade income tax). The plaintiff had been appointed as a provisional liquidator over the assets of a Holding-GmbH which held a 100% interest in X-GmbH.

Prior to the end of the five-year minimum period insolvency proceedings had been instigated. The plaintiff applied for the amendment of the tax assessments already issued, taking into account the fact that the tax group had ceased to exist retroactively because the minimum term had not been met.

Following his unsuccessful appeal to the tax office, the plaintiff appealed to the Nuremberg Tax Court, where the claim was denied. The Supreme Tax Court allowed the appeal, reversed the decision as to the substance of the matter and referred it back to the Nuremberg Tax Court, albeit for different reasons.

Decision

First, the Supreme Tax Court pointed out that, according to the findings of the Nuremberg Tax Court, only preliminary financial statements of X-GmbH for the year 2008 were available. Furthermore, until the date of decision of the tax court, there was no final approval of the annual financial statements as of December 31, 2008.

The Supreme Tax Court went on to state that the Nuremberg Tax Court had wrongly based its decision on the fact that a preliminary annual financial statement was sufficient for the actual implementation of the PTA, that the net income for the year reported by X-GmbH complied with the accounting standards under commercial law, and that the holding company's claim to the entire transfer of profit had already been satisfied by the transfer of the amount into the internal clearing account.

Rather, what matters with respect to the actual implementation of the PTA is the result, that would have to be reported in final annual financial statements if the accounting principles under commercial law had been applied correctly. In the case in dispute, however, this amount was not actually transferred to the holding company under any circumstances.

The non-performance of the PTA for 2008 cannot be remedied analogous to Sec. 14 (1) Sentence 1 No. 3 Sentence 4 Corporation Tax Act (CTA), which deals with the subsequent correction of incorrect balance sheet items in validly adopted annual financial statements. This is not true in the case of dispute, as only provisional annual financial statements are presented.

Failure to consistently apply the PTA throughout the minimum 5 year period can also not be "cured" (analogous) by invoking Sec. 14 (1) Sentence 1 No. 3 Sentence 2 CTA („cancellation before expiry is not harmful if for good cause“) and irrespective of the insolvency.

The non-execution of the PLA during the minimum term of five years, does not only cause an interruption of

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the consolidated tax group under corporate income tax law for specific assessment periods, but also results in the (retroactive) disallowance of the consolidated tax group under corporate income tax law as a whole.

Source:

Supreme Tax Court, decision of 2 November 2022 (I R 29/19) published on 9 February 2023.

Keywords

insolvency, profit pooling agreement, tax group