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By PwC Deutschland | 18 August 2023

Loss from the sale of minority share to spouse no abuse of law

The review to determine the taxpayer’s intention at making a profit for income to qualify as business income under Section 17 German Income Tax Act must be with regard to the taxpayer's entire shareholding in the corporation. An isolated analysis based on the single business share sold is not possible. In its current ruling, the Supreme Tax Court also comments on the question of abuse of rights with the intention to create tax losses in a case of increased acquisition costs because of a (paid) premium.

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Background

The plaintiff (natural person) was the sole shareholder of a GmbH. The share capital initially amounted to € 25,000. In December 2015, the shareholders' meeting of the GmbH approved a capital increase of €1,000. The plaintiff also subscribed for this share and, in addition to the nominal amount, paid a premium of €500,000 into the GmbH's free capital reserves. On 28 December 2015, the plaintiff sold 300 shares with a nominal value of €1 each as well as the newly acquired share for a purchase price of €26,300 to her husband, who henceforth held 5% of the GmbH's capital.

In the joint income tax return for the year in dispute, the plaintiff declared the loss from the sale of the shares in GmbH to be considered pursuant to Sec. 17 Income Tax Act (ITA). The tax office did not agree, but rather took a separate approach. It did not recognize the loss resulting from the sale of the newly acquired business share. Considering the high acquisition costs (€1,000 nominal value plus €500,000 premium), the plaintiff had lacked the intention to generate a business profit as required by the statutes.

The claim of the plaintiff was granted by the lower tax court of Duesseldorf.

Decision

The Supreme Tax Court agreed with the decision of the lower tax court and rejected the tax office's appeal as unfounded, mainly on the following grounds.

The required intention to realize profits must relate to the taxpayer's entire shareholding in the corporation rather than to the individual share sold.

According to Section 17 (1) sentence 1 ITA the sale of shares in a corporation held as private assets is treated and taxed as business income. The taxpayer must acquire and hold the shares in the company with the intention of making profits. This precondition is met even if the investment was held only for a short time. Sec. 17 (1) Sentence 1 ITA does not specify a minimum holding period but instead presupposes that the taxpayer held, either directly or indirectly, at least a share of 1 per cent in the corporation within the last five years prior to the sale. The tax office had denied an intention to generate a profit because the plaintiff held the sold business share for only seven days.

The Supreme Tax Court did not see any doubts as to the plaintiff's intention to realize profits. Overall, it should be considered that the loss in dispute from the sale of the particular share would be offset in the event of the sale of further shares, as the plaintiff would be remunerated for the payment made into the capital reserves of the GmbH.

The premium increases the acquisition cost of that particular share, even if the sum of the nominal amount and the premium exceeds the fair market value of the share.

A premium payable to a corporation above the nominal amount of the contribution and which is shown as a capital reserve in the commercial accounts is part of the consideration the acquirer has pay to obtain the participation rights.

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The premium paid by the plaintiff for the acquisition of the new share cannot be spread among all shares held, at least not for the year in dispute (2015). Although the new version of Section 17 (2a) sentence 5 ITA put into force at the time, and which is referred to by the tax office, specifically provides otherwise it has no retroactive effect as it applies for the first time to disposals after 31 July 2019.

The specific intention to create a loss through the sale of a share in the GmbH whose acquisition costs exceed its market value as a result of a premium, is not necessarily – and from the outset – to be held as an abuse of rights within the meaning of Sec. 42 German Fiscal Code.

On the one hand, it is at the discretion of the taxpayer to structure his transactions in such a way to put him in the most favorable tax position. This includes the option to inject capital into the company in a most tax-effective manner. On the other hand, it has been established by settled case law that the taxpayer can himself decide which share of his investment he sells. This applies no matter whether the sale is made to a third party or to a close relative.

Source:

Supreme Tax Court, decision of 3 May 2023 (IX R 12/22), published on 10 August 2023.

Keywords

Sale of shares, abuse of legal forms, business income