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By PwC Deutschland | 11 June 2024

No application of loss forfeiture rules for losses allocated from partnerships

The loss forfeiture rules of Section 8c of the Corporation Tax Act in the version valid for 2014 are not applicable to deductible losses which are allocated to a corporation as partner of a limited partnership pursuant to Section 15a Income Tax Act. With this decision, the Supreme Tax Court contradicts the view of the tax administration.

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Legal Background

Section 8c Corporation Tax Act (CTA) in the version applicable in 2014 (old version) deals with the curtailment of loss relief for corporations on changes of shareholders: „*Where over the course of five years more than 50 per cent of the issued share capital , membership rights (…) in a **corporation** are directly or indirectly transferred to a single acquirer or its related party or where there is a similar occurrence (harmful acquisition), the negative income not recovered or deducted before the harmful acquisition ceases to be deductible to the extent of the acquisition*“.

Section 15a Income Tax Act (ITA) regulates the tax effects and the restrictions of the losses allocated to limited partners. Put briefly, the losses allocated may only be set against other taxable income up to the level of the partnership capital. Remaining amounts are carried forward but can only be set against future profits from the same partnership. The objective of this provision is to limit the loss relief available to a partner to the level of risk he bears.

Case of dispute

The plaintiff, a GmbH, was a limited partner in a partnership GmbH & Co. KG (KG). The latter incurred substantial losses from its business activities in the past which were partially allocated to the GmbH as partner. The sole shareholder of the plaintiff was a public limited company (AG). Due to the insolvency of the AG and the ensuing corporate restructure a complete change of ownership took place.

In the opinion of the Ministry of Finance, which the tax office has followed in the case of dispute, the curtailment of loss relief pursuant to Section 8c CTA is applicable to all unused losses, it therefore also includes losses pursuant to Section 15a ITA.

The tax court of first instance, however, agreed with the plaintiff’s view and upheld the action.

Decision

The Supreme Tax Court agreed with the decision of the lower court and dismissed the appeal of the tax office as unfounded.

There is no legal basis for refusing the loss relief as Section 8c CTA (old version) is not applicable to offset the losses mentioned in Section 15a ITA which are attributed to a corporation as partner of the KG.

The Supreme Tax Court saw it as a clear-cut case because it is unambiguously indicated already in the heading of Section 8c referring to the „Loss relief for **corporations**“. Accordingly, the provision does not apply to losses of partnerships.

The consequences of a harmful acquisition, namely the non-deductibility and the elimination of unused losses, only affects losses of the corporation and can therefore only occur at the level of the corporation.

A partnership that conducts its own business activities with the purpose to generate profits and thus is subject to the rules for profit determination and qualification of income is not directly affected by the loss

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forfeiture rules.

Section 8c (1) sentence 1 CTA is also not applicable to losses of a KG which are attributable to a corporation as limited partner, and **which are non-deductible** under the conditions specified in Section 15a ITA.

In the opinion of the Supreme Tax Court this approach corresponds to the purpose of Section 15a ITA, which only allows the limited partner to offset and deduct tax losses to the extent that he is economically encumbered by the loss. However, it also shows that the usable losses of the limited partner are tied up at the level of the company. Consequently, they do not represent unused losses of a corporation within the meaning of section 8c (1) sentence 1 CTA, but rather are (previously) unused losses of the partnership.

It is for the above reasons that the Supreme Tax Court could leave aside the question whether Section 8c (1) CTA (old version) is unconstitutional.

Reference:

Supreme Tax Court judgment of 24 April 2024 (IV R 27/21), published on 6 June 2024.

Keywords

Loss relief, partnership income