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By PwC Deutschland | 04 October 2025

Supreme Tax Court rejects loss offsetting scheme with securities

Section 20 (4a) sentence 3 of the Income Tax Act (ITA) provides that certain capital-related measures are initially treated as tax neutral. Taxation only occurs at the time of resale of the securities which were delivered in the course of the capital transaction. In a recent judgment, the Supreme Tax Court decided that this does not apply to cases in which neither the issuer nor the holder has the right under the contractual terms to unilaterally tender securities or demand the delivery of securities instead of repayment of the securities in cash.

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Background

In three cases, the court proceedings dealt with specifically structured securities transactions. The objective of these transactions was to generate, on the one hand, fully deductible losses in view of the expected very high profits to be taxed at the standard rate in future tax periods and, second, to generate high income subject to the special flat tax rate of 25% for investment income (Section 32d ITA). The intention was to offset the anticipated very high taxable profits against the losses and ultimately to avoid the top tax rate of 45% and instead paying essentially only the special investment tax rate of 25%.

The taxpayers acquired partial debentures of an index-linked bond. *An index-linked bond is a bond in which payment of interest income on the principal is related to a specific price index. It has a fixed term and is due on the repayment date.* Upon maturity of the bond, the issuer was required to deliver a less expensive security (in this case, a TecDax certificate) for each partial debenture and to pay the balance in cash. The issuer had no right, either upon maturity of the bond or before, to repay the bond in cash instead nor could the holder at any time demand repayment exclusively in cash from the issuer .

The success of the structure relied on the application of Section 20 (4a) ITA: The amount of money received would have been taxable at the special rate for investment income pursuant to Section 20 (4a) sentence 2 ITA. The redemption of the partial debenture against delivery of the security would not have resulted in a profit, because - according to Section 20 (4a) sentence 3 ITA - the acquisition costs for the partial debenture would have had to be recognized as the sale price and the calculated profit would thus be €0.

The **Supreme Tax Court** held that section 20 (4a) sentence 3 ITA does not cover cases in which neither the issuer nor the holder has the right under the terms of the bond to unilaterally tender securities or demand the delivery of securities in lieu of repayment of the bond in cash. The decision is primarily based on the wording of that provision. In all three cases the intended purpose of the design could therefore not be achieved.

Source:

Supreme Tax Court, decisions of 7 May 2025 VIII R 9/22, VIII R 18/23 and VIII R 35/23 - - published on 2 October 2025.

Keywords

capital investment income, loss offset, securities dealings