

# ***German change of control rules on loss limitation declared invalid by Constitutional Court***

*May 2016*

## **In brief**

A decision of the German Federal Constitutional Court of 29 March 2017 has now been published. In this decision the Court declares the German change of control rules on loss limitation in case of a partial ownership change (i.e. more than 25% and up to 50%) to be unconstitutional as from 2008. The Court left it explicitly open whether this rule is also unconstitutional in case of a change of control of more than 50%.

## **General background**

The direct or indirect transfer of more than 25% up to 50% of the shares, voting or other relevant rights in a corporation to an acquirer or person(s) related to the acquirer or a group of acquirers with an aligned interest, within five years, generally results in a pro rata forfeiture of tax loss carry forwards (TLCFs) as well as current tax year losses and interest carry forwards (ICFs).

In case of a change in ownership of more than 50% all TLCFs, current tax year losses, and ICFs forfeit.

There are three major exemptions. The change of control rules are not applied:

- (1) if transferor and transferee are ultimately held at 100% by the same parent (so-called intra-group exception);
- (2) to the extent that the loss company carries taxable built-in gains in its taxable net assets (so-called built-in gains exception);
- (3) if the loss company used to have and continues to have the same business and no harmful event takes place, e.g. participation in a partnership, becoming the parent company within a tax group, transfer of assets below the fair market value, etc. (sec. 8d, introduced in 2016).

## **The decision**

In its decision, the German Federal Constitutional Court declares the German change of control rules in case of a partial ownership change (i.e. more than 25% and up to 50%) to be unconstitutional as from 2008.

The Court asks the lawmaker to retroactively amend the partial change of control rules until 31 December 2018 the latest. Otherwise the rules will not be applicable anymore from 2008 onwards.

The Court left it explicitly open whether the change of control rule in case of a change of control of more than 50% is also unconstitutional.

## **Take aways**

All cases as from 2008 onwards where a partial change of control occurred should be revisited and kept open but also cases with a change of control of more than 50%; both in respect of TLCFs, current tax year losses and / or ICFs.

It is very difficult to predict at this point how the lawmaker will react and adjust the law retroactively and which additional requirements will be retroactively introduced to comply with the constitution. It is also argued that the 2016 addition (sec. 8d), though extremely narrow in its scope, may have already resolved the issue from 2016 going forward. We will keep you posted.

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