

Update: German loss forfeiture rules questioned to be unconstitutional for share transfers of more than 50%

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In brief

On 29 August 2017, the Fiscal Court Hamburg decided to refer a case to the German Federal Constitutional Court, because they question, whether the German change of control rules on loss limitation in case of an ownership change of more than 50% are conform to the constitution. In May 2017, the German Federal Constitutional Court has already declared the German change of control rules on loss limitation in case of a partial ownership change of more than 25% and up to 50% to be unconstitutional.

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

The Fiscal Court Hamburg questions, whether the German change of control rules in case of an ownership change of more than 50% are conform to the constitution as from 2008. Therefore, the Court has referred the case to the German Federal Constitutional Court.

In May 2017, the German Federal Constitutional Court has already asked the lawmaker to retroactively amend the loss forfeiture rules regarding a change of control of more than 25% and up to 50% until 31 December 2018 the latest. Otherwise the rules will not be applicable anymore from 2008 onwards.

Takeaways

It is very difficult to predict at this point whether the Constitutional Court will declare the loss forfeiture rules for changes of control of more than 50% to be unconstitutional and if so, how the lawmaker will react and adjust the law retroactively. It is argued that the 2016 addition (sec. 8d), though extremely narrow in its scope, may have already resolved the issue from 2016 going forward.

We recommend to revisit and keep open all cases as from 2008 onwards where a harmful change of control has occurred in respect of TLCFs, current tax year losses and / or ICFs. We will keep you posted.

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