Deloitte.

URL: http://www.deloitte-tax-news.de/german-tax-legal-news/ec-opens-formal-investigation-on-relief-from-change-in-ownership-rule-for-ailing-companies-under-state-aid-rules.html

23.03.2010

German Tax and Legal News

European Commission opens formal investigation on relief from change in ownership rule for ailing companies under state aid rules

The European Commission announced on 24 February 2010 that it has opened a formal investigation (Case NN 5/2010) into the restructuring exception to Germany's change in ownership rule in section 8c of the Corporate Income Tax Code.

Under section 8c, a direct or indirect share transfer to one shareholder will result in a pro rata (in the case of a transfer of more than 25% of the shares) or complete (in the case of a transfer of more than 50% of the shares) forfeiture of tax loss carryforwards.

The restructuring exception, however, allows ailing companies that have the potential for a turn-around to retain tax loss carryforwards if certain additional conditions are satisfied. The restructuring exception was introduced in July 2009 with retroactive effect for harmful share transfers taking place as from 1 January 2008. Although the measure was intended to expire on 31 December 2009, it was made permanent in December 2009 by the Law to Accelerate Economic Growth. That law also amended other aspects of the change-in-ownership rule (e.g. it introduced an intragroup exception and the ability to carry forward losses to the extent built-in gains in the loss company are subject to tax in Germany), but neither of these provisions is affected by the Commission's investigation.

The main element for determining whether a tax measure is considered state aid is the selectivity of the measure. (The other prerequisites for a state aid finding, such as the use of state resources and a distortion of competition/trade, are usually present in the case of tax measures). The Commission is concerned that the restructuring exception might confer a selective advantage on certain undertakings that cannot be justified by the nature and general scheme of the German tax system because while both ailing and healthy companies could be loss-making, only ailing companies are allowed to retain tax loss carryforwards after a harmful share transfer (provided the other requirements are met). By opening the formal investigation, which is the second stage of the state aid procedure, the Commission gives interested parties an opportunity to comment on the measures.

The fact that the German government did not notify the European Commission before the new law was enacted is problematic. Any plans to enact legislation that constitutes potentially new aid must be notified to the Commission and such aid must not be put into effect before it is approved by the Commission. State aid measures that have not been notified and that have been found to be incompatible with the EC Treaty are usually considered illegal aid and any benefits obtained by taxpayers from such measures must be recovered.

Because Germany failed to comply, a decision by the Commission that the restructuring exception constitutes state aid likely would mean that the advantage conferred by the measure would have to be recovered. In that case, companies making use of the provision could retroactively lose their tax loss carryforwards and, if they had already set off all or part of the loss carryforwards against profits, could be required to repay any tax advantages resulting from the use of the loss carryforwards after the harmful change in ownership. Even companies making use of the restructuring exemption in good faith could not rely on the protection of legitimate expectations, regardless of any statute of limitations that would be applicable under regular procedural rules.

The European Commission's decisions in state aid cases are political and hard to predict, so it is difficult to speculate on the outcome of the investigation.

If you have any questions, please contact the authors of this article at gtln@deloitte.de or your regular Deloitte contact.

www.deloitte-tax-news.de