Deloitte.

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BFH rules on forfeiture of tax loss carryforward in share transfer to parties acting in concert

BFH decision conflicts with MOF guidance

In a decision dated November 22, 2016, published on June 14, 2017, Germany's Federal Tax Court (BFH) ruled that a harmful share transfer to parties acting in concert will arise only if several acquirers (i) cooperate in the direct or indirect acquisition of a loss company; and (ii) entered into agreements allowing a controlling influence following the acquisition. The agreements must exist on the acquisition date at the latest, and the tax authorities have the burden of proving that the parties are acting in concert.

In the case before the BFH, the taxpayer had indirectly transferred 53% in a loss-making company to three parties (individuals and legal entities) in fiscal year (FY) 2010, a year in which the company had incurred a loss. Based on guidance issued by the tax authorities in 2008 on the use of losses following a harmful share transfer, the competent tax office took the position that the loss incurred in FY 2010 had to be calculated pro rata and that the tax loss carryforward as at December 31, 2009 had been forfeited. The tax office stated that the acquirers had to be considered as parties acting in concert. The taxpayer appealed the decision to the lower tax court of Lower Saxony.

Under the general change-in ownership rules, a direct or an indirect change in ownership of more than 25% but not more than 50% to a single acquirer, related party or parties acting in concert generally results in a partial forfeiture of all tax losses that were not used by the time of the harmful share transfer. Where there has been more than a 50% change in the direct or indirect ownership, all of the loss carryforwards are forfeited. According to guidance issued by the tax authorities on the application of the loss transfer rules, the "parties acting in concert" condition requires that parties have a "common interest." According to the tax authorities' guidance, a common interest generally is present if there is an agreement between the parties (even in the absence of a written contract), and that a common controlling influence (i.e. a majority of the voting rights) is evidence that parties are acting in concert.

The BFH did not agree with the tax authorities. The BFH confirmed that the wording of the law leaves open at which aim the common interest has to target. The BFH held that the law aims to prevent the compensation of profits incurred under one economic engagement and losses incurred under another. The BFH further stated that the purpose of the law is to prevent abuse of the rules where four different parties each acquire 25% in a loss-making company. The BFH agreed with the lower tax court that common agreements of the acquirers relating to the acquisition, standing alone, are not sufficient evidence to presume parties are acting in concert. A new economic engagement requires that the acquirers be willing and able to act as parties in concert in the future based on agreements existing on the acquisition date. A mere controlling influence due to a majority of voting rights is not sufficient. In the case before the BFH, the articles of association did not include any stipulation regarding a uniform exercise of voting rights. Further, as stated above, the tax authorities have the burden of proving the existence of parties acting in concert.

The BFH's decision is the first dealing with the definition of parties acting in concert for the change-in-ownership rules.

Note: In a decision issued on March 29, 2017, the Federal Constitutional Court held that the change-in-ownership rules were partially unconstitutional (see GTLN dated May 15, 2017).