Deloitte.

URL: http://www.deloitte-tax-news.de/german-tax-legal-news/local-tax-court-clarifies-requirement-for-early-termination-of-tax-group.html

06.01.2016

German Tax and Legal News

Local tax court clarifies requirement for early termination of tax group

Intragroup restructuring may constitute an important reason for terminating tax consolidation before the end of the minimum five-year period

The Local Tax Court of Hesse issued a decision on 28 May 2015 that provided welcome clarification of the requirements for the early termination of a profit & loss transfer agreement (PLTA). The local tax court clarified a 2013 decision of the federal tax court, in which the federal court stated that an intragroup restructuring will not automatically qualify as an "important reason" to terminate a tax group before the expiration of the required minimum five-year period.

One of the requirements to establish an income tax consolidation between two German entities is that the parent entity and its subsidiary enter into a PLTA for at least a five-year period; the subsidiary is required to transfer all of its domestic GAAP net income to the parent and the parent must compensate the subsidiary for the domestic GAAP net loss. Once a valid income tax consolidation is set up, the parent company becomes the sole taxpayer of the income tax-consolidated entities and all taxable profits/losses of the subsidiaries are allocated to the parent.

A termination of the PLTA before the end of the five-year period generally results in a retroactive denial of the income tax consolidation (e.g. if the PLTA is terminated after four years, the consolidation generally will be disallowed retroactively as from year one), unless there is an "important reason" for the termination. Although this term is not defined in the law, the German tax authorities have issued guidance that states that the sale of the shares in a consolidated subsidiary by the parent entity might qualify as an important reason for an early termination of a PLPA.

In the case before the Local Tax Court of Hesse, a German parent company and its 100% German subsidiary concluded a PLTA. Three years later, the German parent contributed the subsidiary to a newly established German holding company (which was wholly owned by the German parent). The existing PLTA between the German parent company and its (former) subsidiary was terminated nearly three months after the contribution. New PLTA's between the German parent company and the holding company and the holding company and the German subsidiary were then concluded. The holding company was established because the group introduced a new business unit organizational structure.

The tax authorities denied the existence of the tax group between the German parent and the former subsidiary with retroactive effect because it was terminated before the end of the five-year term and there was no important reason for the termination. The tax office based its view on the fact that the termination took place nearly three months later after the relevant contribution agreement was concluded.

The local tax court disagreed with the tax authorities and decided in favor of the taxpayer. In its decision, the tax court provided additional guidance on the existence of an "important reason" and made it clear that valid business reasons must exist in an internal restructuring to allow an early termination of a PLTA (and tax reasons do not qualify). The inclusion and description of important reasons in the PLTA or in the guidance issued by the tax authorities will not automatically result in the acceptance of an early termination; objective criteria are used to determine whether a reason for the termination is sufficient.

The tax court made it clear that it ruled for the taxpayer because (i) the taxpayer presented a valid business reason for the restructuring; (ii) the subsidiary was immediately included in a new tax group that was headed by the German parent company; and (iii) the taxpayer produced evidence that, from the outset, all parties involved intended to set up the new PLTAs between the three companies.

Although the tax court opinion appears to be taxpayer favorable, it does not lower the bar for terminating a PLTA before the end of the five-year term without harmful tax effects in

the case of internal reorganizations. Taxpayers should analyze each situation carefully and provide valid business reasons for an internal restructuring in order to terminate a PLTA early; consultation with the tax authorities (e.g. in the form of a binding ruling) is recommended.

The decision of the local tax court is final, since the court did not allow an appeal to the federal tax court.

www.deloitte-tax-news.de

Diese Mandanteninformation enthält ausschließlich allgemeine Informationen, die nicht geeignet sind, den besonderen Umständen eines Einzelfalles gerecht zu werden. Sie hat nicht den Sinn, Grundlage für wirtschaftliche oder sonstige Entscheidungen jedweder Art zu sein. Sie stellt keine Beratung, Auskunft oder ein rechtsverbindliches Angebot dar und ist auch nicht geeignet, eine persönliche Beratung zu ersetzen. Sollte jemand Entscheidungen jedweder Art auf Inhalte dieser Mandanteninformation oder Teile davon stützen, handelt dieser ausschließlich auf eigenes Risiko. Deloitte GmbH übernimmt keinerlei Garantie oder Gewährleistung noch haftet sie in irgendeiner anderen Weise für den Inhalt dieser Mandanteninformation. Aus diesem Grunde empfehlen wir stets, eine persönliche Beratung einzuholen.

This client information exclusively contains general information not suitable for addressing the particular circumstances of any individual case. Its purpose is not to be used as a basis for commercial decisions or decisions of any other kind. This client information does neither constitute any advice nor any legally binding information or offer and shall not be deemed suitable for substituting personal advice under any circumstances. Should you base decisions of any kind on the contents of this client information or extracts therefrom, you act solely at your own risk. Deloitte GmbH will not assume any guarantee nor warranty and will not be liable in any other form for the content of this client information. Therefore, we always recommend to obtain personal advice.