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German Tax and Legal News

New decision on cross-border loss relief between corporations

Following a recent decision of the local tax court of Lower Saxony (see Deloitte Tax-News), the local tax court of Rheinland-Pfalz has also ruled on a case in which a German resident parent company claimed relief for losses incurred by its EU subsidiary. The German parent had a wholly owned Danish corporate subsidiary that incurred substantial losses and that was liquidated in 2005, with significant tax loss carryforwards unutilized at the time of liquidation. The German parent applied for a deduction of the losses incurred by the Danish subsidiary arguing that, under the principles enunciated in the European Court of Justice's (ECJ) 13 December 2005 decision in the Marks & Spencer case, final losses of an EU-based subsidiary must be deductible at the level of the parent company even if no profit and loss pooling agreement (PLPA) was in place between the companies. A PLPA is a prerequisite for forming a German tax group (Organschaft) between two domestic entities. Most EU Member States, including Denmark, do not provide for the possibility to conclude such agreements.

In its decision of 17 March 2010 (case reference 1 K 2406/07), the local tax court of Rheinland-Pfalz rejected the claim of the parent company. According to the court, the parent company was not even in a situation comparable to the head of a domestic tax group and, therefore, it rejected the argument that there was a restriction of the freedom of establishment principle under the EU Treaty. The court held that the absence of a five-year contractual obligation of the parent company to offset the losses of the subsidiary (which would be the case between German entities under a PLPA) barred the claimant from a cross-border deduction of final losses. It further concluded that, even if the disallowance of a loss deduction at the level of the parent company does constitute a restriction, that restriction would be justified by the need to protect the balanced allocation of taxing rights between the Member States. Furthermore, the court questioned whether German parent companies generally can be prohibited from claiming a deduction for final losses under the Marks & Spencer principles because in a comparable domestic situation, any liquidation losses at the level of a subsidiary would not be considered at the level of the parent company under the Organschaft rules.

The claimant has appealed the tax court's decision and the case is now pending before the Federal Tax Court (BFH, case reference I R 34/10). It remains to be seen whether the Federal Tax Court will refer these cases to the ECJ.

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

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