

German Loss Forfeiture Rules (*Verlustuntergang*): News Regarding the Transfer of Shares During a Financial Year

Under the loss forfeiture rules, a corporation's current losses and loss carried forwards are subject to a change in ownership of the shares. According to these rules, losses and loss carried forwards will forfeit partially if more than 25% but less than 50% of the nominal capital, membership rights or voting rights in a corporation are directly or indirectly transferred to an acquirer or to its related parties within five years. Unused losses and loss carried forwards will forfeit in full where more than 50% of the shares or voting rights are transferred within five years.

In 2008 the German Federal Ministry of Finance (*BMF*) issued a circular on the application of the loss forfeiture rules. According to the BMF, the tax authorities took the position that profits generated in the year in which the change in ownership takes place (e.g. on 30 June) cannot be offset with existing loss carried forwards. However, with the decision of 30 November 2011, the Federal Fiscal Court (*BFH*) determined – in contrast to the position of the BMF – that loss carried forwards are relievable against the profit of the current financial year before the harmful share transfer.

In April 2014 the BMF published a new draft circular with a significant change of their former position regarding a share transfer during a financial year. According to the BMF a profit generated until the harmful share transfer (e.g. on 30 June) may now be generally offset against unused losses or loss carried forwards. However, the BMF is willing to concede such offset only in case the result of the respective financial year is overall positive. The tax authorities also take the position that the result of the financial year should, from now on, be allocated on the basis of economic criteria, where formerly an allocation on a pro rata basis was generally accepted.

Interest Deduction Ceiling: Federal Fiscal Court (*BFH*) has Serious Doubts with Regards to the Constitutionality

In Germany, a general limitation to the deduction of interest payments applies for Corporate Income Tax and Trade Tax purposes (so called interest deduction ceiling: *Zinsschranke*). The rules are relating to both third party loans and shareholder loans. Under the interest deduction, ceiling interest expenses exceeding interest income (net interest) will only be deductible up to 30% of the corporation's EBITDA (earnings before interest, taxes, depreciation and amortization).

The interest deduction ceiling will apply (a) if the overall net interest exceeds €3 million (threshold) and (b) in case the corporation does not belong to a group of companies, if a "harmful debt financing" is in place, which is a debt financing by shareholders with more than 25 % shareholding, related parties or third parties (e.g. banks) with recourse to such shareholders or related party, and interest paid for such debt exceeds 10 % of the overall net interest; or (c) in case the corporation belongs to a group of companies, if "harmful debt financing" exists in any group company and the financing 25% shareholder, related party or third party with recourse to the shareholder or related party is not part of the group; or the equity ratio of the borrowing corporation is lower than the one of the consolidated group. Net interest expenses that are not deductible under these rules may be carried forward to subsequent financial years and may only be deducted within the limits of the interest deduction ceiling.

With decision as of 18 December 2013 and published on 16 April 2014 the BFH has expressed serious doubts with respect to the constitutionality of the interest deduction ceiling. According to the BFH, the rules violate the objective net principle and the BFH states that a justification for the limitation of interest deduction cannot be identified, neither as an anti-abuse rule nor as a fiscal purpose. As a consequence all tax assessment notices which are affected by the interest deduction ceiling should be kept open. Also it is important that there are further proceedings before the fiscal courts to be decided upon by the BFH during 2014 or 2015. It can be expected that the German Federal Constitutional Court (*Bundesverfassungsgericht*) will have to decide on the constitutionality of the interest deduction ceiling. Thus, the German Federal Constitutional Court may ask the legislator for a new rule with future effect or may declare the interest deduction ceiling unconstitutional with retroactive effect.

Contact Information

Dr. Christian Bleschke
Rechtsanwalt, Steuerberater
Fachanwalt für Steuerrecht
Partner
T +49 30 72 616 8220
E christian.bleschke@squirepb.com

Squire Patton Boggs Berlin
Unter den Linden 14
10117 Berlin
Germany

Squire Patton Boggs Frankfurt
Taunusanlage 17
60325 Frankfurt am Main
Germany