Corporate Tax - Germany

Is the Corporation Tax Act change of control rule unconstitutional?

Contributed by P+P Pöllath + Partners Attorneys - Tax Advisors

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Introduction

On April 4 2011 the local tax court of Hamburg requested the Federal Constitutional Court to consider whether the German change of control rule of Section 8c of the Corporation Tax Act is compliant with the German Constitution (Decision 2 K 33/10, published on May 25 2011). The second chamber of the Hamburg local tax court holds the view that Section 8c of the act is not in line with either the principle of equality as stipulated by the German Constitution or the subsequently derived principle of economic capability. In light of the constitutionally required equality of tax burden, taxpayers with an equal economic capability must be taxed equally. Thus, according to the second chamber of the Hamburg local tax court, Section 8c of the Corporation Tax Act violates the net principle as derived from the principle of economic capability, as well as the principle of coherence.

Change of control rule

Section 8c of the Corporation Tax Act was introduced on January 1 2008 to replace the former Section 8(4). The newly introduced rule aims to prevent trade referring to tax losses through the sale of shares in a corporation. Section 8c limits the offset of tax losses as well as the carry over of tax losses in case more than 50% of the nominal share capital, the membership rights, the ownership rights or the voting rights in a company will be transferred indirectly or directly to one single acquirer or to persons related to the acquirer, or where a comparable event (eg, agreements relating to votes or contributions) arises. If more than 25% but less than 50% of the abovementioned rights are to be transferred, Section 8c leads to a partial tax loss forfeiture. Such forfeiture not only applies to corporate tax loss carry forwards, but also to trade tax loss carry forwards (Section 10a of the Trade Tax Act) and the interest expense carry forward (Section 8a(1) of the Corporation Tax Act). The broad application and the practical issues associated therewith have resulted in several amendments to the change of control rule in the past, in order to avoid unwanted results. An exemption for intra-group transfers and for existing built-in gains was introduced by the Stimulus Act, which was modified by the 2010 Annual Tax Bill.

Recommended action

In light of the case pending at the Federal Constitutional Court on the constitutionality of the German change of control rule, all related tax assessment notices are to be kept open. In case the respective assessment notice has not been issued under reservation as to verification (Section 164 of the General Tax Act), an appeal should be filed within one month of the announcement of the assessment notice. Parties which are undertaking M&A transactions (ie, purchases and sales) should take this into account when reaching agreements.

Further important decisions

Both the Hesse local tax court (Decision 9 K 1842/10K, October 7 2010) and the Münster local tax court (Decision I R 14/11, November 30 2010) have ruled against the view of the German tax authorities that where a harmful share transfer occurs during a fiscal year, profits derived until the effective date of the harmful share transfer may be offset against existing tax loss carry forwards. Therefore, the corresponding assessment notices should also be kept open.

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