

Constitutional Court Examining Change of Control Rule

by Pia Dorfmueller and Sabine Demel

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COUNTRY DIGEST

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The local tax court of Hamburg, Germany, on April 4 submitted to the German Federal Constitutional Court a request for a ruling (2 K 33/10, published May 25) on whether the German change of control rule of section 8c of the Corporation Tax Act (CTA) complies with the German Constitution.

The second chamber of the Hamburg local tax court believes section 8c CTA conforms with neither the principle of equality provided in the German Constitution nor the subsequently derived principle of economic capability. In light of the constitutionally mandated equality of tax burdens, taxpayers with an equal economic capability must be equally taxed. According to the second chamber of the court, section 8c CTA violates the net principle as derived from the principle of economic capability as well as the principle of coherence.

Overview of the Change of Control Rule

Section 8c CTA was introduced January 1, 2008, and replaced the former section 8(4) CTA. The new rule was intended to prevent any trade in tax losses through the sale of shares in a corporation. Section 8c CTA limits the offset of tax losses as well as the carryover of tax losses when more than 50 percent of the nominal share capital, of the membership rights, of the ownership rights, or of the voting rights in a company will be transferred indirectly or directly to one single acquirer or to persons related to the acquirer or when a comparable event arises. If more than 25 percent but less than 50 percent of those rights will be transferred, section 8c CTA causes a partial tax loss forfeiture. This forfeiture applies not only to corporate tax loss carryforwards but also to trade tax loss carryforwards (section 10a, sentence 10, Trade Tax Act) and the interest

expense carryforward (section 8a(1), sentence 3 CTA). The broad application and resulting issues in practice have led to several amendments of the change of control rule in order to avoid unwanted results. Exemptions for intragroup transfers and existing built-in gains were introduced by the Stimulus Act, which has already been modified by the 2010 annual tax bill. (For prior coverage, see *Doc 2009-24783* or *2009 WTD 218-5*; see also *Doc 2008-5778* or *2008 WTD 53-6*.)

Recommended Actions

In light of the pending case at the Federal Constitutional Court on the constitutionality of the change of control rule, all related tax assessment notices will be kept open. If a related notice isn't issued as reserved pending verification (section 164 General Tax Act), an appeal should be filed within one month of the announcement of the assessment notice. Parties to merger and acquisition transactions (purchases/sales) should take this into account in the agreements.

Other Important Decisions

Both the local tax court of Hesse (resolution of October 7, 2010, 9 K 1842/10 K) and the local tax court of Munster (decision of November 30, 2010, I R 14/11) have ruled contrary to the position of the German tax authorities that in the case of a harmful share transfer occurring during a fiscal year, profits derived until the effective date of the harmful share transfer may be offset against existing tax loss carryforwards. Therefore, the corresponding assessment notices should be kept open. (For prior coverage, see *Tax Notes Int'l*, May 9, 2011, p. 466, *Doc 2011-9081*, or *2011 WTD 83-2*.) ♦

♦ *Pia Dorfmueller and Sabine Demel, P+P Pöllath + Partners, Frankfurt*