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German Tax and Legal News

BFH rules tax authorities' guidance providing waiver of tax on recapitalization gains is unconstitutional

Each case must be decided on its own merits

In a decision of general principle (GrS 1/15) issued on November 28, 2016 (and published on February 8, 2017), the leading senate of Germany's Federal Tax Court (BFH) held that guidance issued by the tax authorities, which grants a general waiver of tax on recapitalization gains, violates the German constitution. The BFH stated that each case must be considered on its own merits in determining whether a waiver should be granted.

The BFH held that the requirements for a tax waiver, set out in special provisions in the General Tax Code, allow a tax waiver only if taxation leads to "factual inequity" based on an analysis of the particular case. According to established jurisprudence, factual inequity will be presumed only in exceptional cases. A waiver of tax granted by the tax authorities based on their interpretation, in generally applicable guidance, of factual inequity violates constitutional law because the tax authorities do not have legislative powers.

Based on a decree issued by the Frankfurt tax authorities on February 22, 2017, it now is being discussed at a state and federal level whether the guidance on tax waivers issued by the tax authorities remains applicable despite the BFH's decision because of the principle that taxpayers should be able to rely on existing administrative procedure.

Until the tax authorities issue a final decision how to proceed in these matters, they will not approve any applications for a waiver of tax based on the guidance, nor will they decide on binding ruling applications. The Federal Council (Bundesrat) has suggested to the parliament that it considers enacting a law that specifically addresses the requirements for factual inequity in order to obtain a waiver of tax in the case of rehabilitation measures.

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