

Federal tax court rejects cross-border tax consolidation without actual loss transfer or agreement

Court denies violation of EU law in the decided case and does not involve the CJEU

In a decision dated 9 August 2023 (and published on 14 December 2023), Germany's federal tax court (BFH) ruled that a German controlling parent entity could not deduct the losses of its French subsidiary since the parent entity did not actually compensate the subsidiary for the losses and the parties neither expressed an intention nor met the requirements to form a tax consolidated group.

Background

Based on the German tax consolidation (Organschaft) rules, the profits and losses of a controlled subsidiary may be offset against profits and losses at the level of the controlling parent entity, provided a profit and loss pooling agreement (PLPA) between the parent entity and the subsidiary has been concluded for at least a five-year period and the PLPA has been filed with the commercial register. Unlike tax consolidation rules in most jurisdictions, the Organschaft rules are based on legal obligations arising from the PLPA, under which the controlled subsidiary is required to annually transfer its profits to the controlling parent entity and such parent entity is required to compensate the subsidiary for its annual losses. The Organschaft is more than just a tax concept in Germany – it is a legal concept that has tax, legal, and accounting consequences.

Another requirement for an Organschaft is that the controlled subsidiary must be a corporation with its place of management in Germany and its statutory seat in an EU or EEA member state (however, for the year in question (i.e., 2012), the Organschaft rules still required that the controlled subsidiary has its place of management and statutory seat in Germany).

In an EU/EEA cross-border context, i.e., a German controlling parent and an EU/EEA controlled subsidiary, it is debated in German tax literature (especially in the absence of BFH jurisprudence) how the Organschaft rules must be interpreted considering the EU freedom of establishment principle and past decisions of the Court of Justice of the European Union (CJEU) regarding cross-border losses, since most other EU/EEA jurisdictions do not have a similar concept of a PLPA under their corporate law and in such jurisdictions it may not be possible to register a PLPA in the local commercial register.

Facts of case

In the case brought forward to the BFH, a French corporation was wholly owned by a German GmbH. The French subsidiary had its statutory seat in France and incurred losses over an extended period of time. The German GmbH continued to sell goods to its French subsidiary and write-off the corresponding receivables for German GAAP purposes at year end, as the French subsidiary was not able to repay its debt. Subsequently, the French subsidiary was merged into the German GmbH without liquidation (transmission universelle de patrimoine (TUP)) with effect as of the end of October 2012. No formal PLPA or other agreement existed that required the German GmbH to compensate its French subsidiary for losses, and France does not have a concept similar to that of a PLPA under its corporate law. In the 2012 corporate income tax return, the German GmbH deducted the annual loss (as well as the loss carryforwards) of its French subsidiary, which the tax authorities denied. Upon appeal, the lower tax court of Schleswig-Holstein also rejected this approach and ruled that the losses were not deductible (see [GTLN dated 11/14/19](#)), after which the German GmbH further appealed to the BFH.

BFH decision

The BFH ruled that the losses of the French subsidiary were not deductible based on the Organschaft rules. A key aspect for the BFH was that there was no binding legal agreement between the German GmbH and its French subsidiary that provided for the compensation of losses as required by the Organschaft rules, nor did the parties express their intention or undertake measures for such compensation (i.e., there was no de facto agreement). The

German GmbH continued to provide debt financing to its subsidiary (in form of delivered goods), meaning that the German GmbH did not effectively compensate the French entity for its losses as required by the Organschaft rules. The BFH emphasized that a taxpayer cannot retroactively argue to benefit from the Organschaft rules without having at least expressed an earlier intention to form a tax consolidated group and to try to meet the requirements thereof. As such, in the absence of an actual transfer of losses and because there were no indications that the parties had intended to establish an actual profit and loss compensation mechanism, this was sufficient for the BFH to reject the appeal.

According to the BFH, its decision is in line with EU law, as it is treating the case at hand the same way as if both entities were German entities without having a PLPA in place; in such a case, the losses of the subsidiary cannot be taken into account at the level of the parent entity. As a result, the BFH was not required to finally conclude on the requirements of the Organschaft rules in light of the EU freedom of establishment principle and whether a formal PLPA is a strict requirement to form an Organschaft with a subsidiary in another EU/EEA jurisdiction.

Comments

From a practical perspective, the implementation of an EU/EEA cross-border Organschaft generally is not possible due to the challenges of concluding a formal PLPA, which is a concept that is either unknown under the corporate law of the other EU/EEA jurisdiction or cannot be implemented in a similar manner as provided under German corporate law (e.g., the registration requirement with the commercial register). In addition, the view of the tax authorities that the PLPA must be in line with German corporate law principles also makes implementation of a formal PLPA difficult in a cross-border context. In this highly anticipated decision, tax practitioners were hoping that the BFH would take the opportunity to provide guidance as to if and to what extent a cross-border Organschaft is possible in light of EU principles and what the requirements would be with regard to the PLPA. Unfortunately, the BFH rejected the appeal without concluding on these questions due to the specific facts of the case, including the lack of an actual loss transfer to the parent entity.

The BFH made an interesting statement, however, that if there would have been a contractual or factual loss transfer (without explicitly referring to a PLPA) between the German parent entity and its French subsidiary, the BFH might have been required to request a ruling from the CJEU if and to what extent the PLPA requirement is in line with EU principles. It might be possible to interpret this statement in a way that the BFH (in line with previous decisions from lower tax courts) has doubts that the strict requirements of the PLPA as part of the Organschaft rules are in line with EU principles.

Until a future decision in this regard and potential clarification by the CJEU, it will be challenging to implement a cross-border Organschaft with a controlled EU/EEA subsidiary.

Diese Mandanteninformation enthält ausschließlich allgemeine Informationen, die nicht geeignet sind, den besonderen Umständen eines Einzelfalles gerecht zu werden. Sie hat nicht den Sinn, Grundlage für wirtschaftliche oder sonstige Entscheidungen jedweder Art zu sein. Sie stellt keine Beratung, Auskunft oder ein rechtsverbindliches Angebot dar und ist auch nicht geeignet, eine persönliche Beratung zu ersetzen. Sollte jemand Entscheidungen jedweder Art auf Inhalte dieser Mandanteninformation oder Teile davon stützen, handelt dieser ausschließlich auf eigenes Risiko. Deloitte GmbH übernimmt keinerlei Garantie oder Gewährleistung noch haftet sie in irgendeiner anderen Weise für den Inhalt dieser Mandanteninformation. Aus diesem Grunde empfehlen wir stets, eine persönliche Beratung einzuholen.

This client information exclusively contains general information not suitable for addressing the particular circumstances of any individual case. Its purpose is not to be used as a basis for commercial decisions or decisions of any other kind. This client information does neither constitute any advice nor any legally binding information or offer and shall not be deemed suitable for substituting personal advice under any circumstances. Should you base decisions of any kind on the contents of this client information or extracts therefrom, you act solely at your own risk. Deloitte GmbH will not assume any guarantee nor warranty and will not be liable in any other form for the content of this client information. Therefore, we always recommend to obtain personal advice.