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German Tax and Legal News

Lower tax court clarifies change-in-ownership rules

Lower tax court rejects tax authorities' interpretation of the definition of parties acting in concert in the change-in-ownership rules

The lower tax court of Lower-Saxony issued a decision dated 26 February 2015, in which it rejects the German tax authorities' broad interpretation of the definition of "parties acting in concert" for purposes of the change-in-ownership rules. The lower tax court concluded that for parties to be considered to be acting in concert for these purposes, it is insufficient for the parties to have coordinated and aligned their acquisitions of ownership interests in a loss company; the parties also must pursue common economic interests regarding their investments, and this pursuit must be agreed upon at the time of the relevant change in ownership.

Under the German change-in-ownership rules, a direct or indirect transfer of more than 50% of the ownership in a company to one acquirer, together with related parties and parties acting in concert, may lead to a forfeiture of net operating loss (NOL) carryforwards, interest carryforwards and current-year losses of the company. A direct or indirect transfer of between 25% and 50% of ownership to one acquirer, together with related parties and parties acting in concert, could result in a pro rata forfeiture of the same tax attributes. All ownership changes within a five-year period are counted together.

The case decided by the lower tax court involved a German GmbH (ABC-GmbH) that held 53% of the shares in a German loss company. Shareholders A and B each held 37.37% of ABC-GmbH, while C held 24.54%. A, B and C transferred all of their shares to three other (direct and indirect) shareholders of the German loss company, so that each of the new shareholders held one-third of ABC-GmbH after the transaction. Indirectly, only 17.67% (53% of 33.33%) of the shares in the German loss company were transferred to each new shareholder in the transaction. The tax authorities took the position that, based on the coordinated and aligned transaction, the three new shareholders in ABC-GmbH had to be treated as parties acting in concert and, as a result, the NOL carryforwards of the German loss company were forfeited.

The lower tax court rejected the tax authorities' arguments and provided some general comments regarding the term "parties acting in concert." According to the court, the mere (direct or indirect) shareholding of several shareholders in a loss company does not qualify as a joint and common interest in the company that forms the basis for parties acting in concert. The same applies for a common interest in the economic development of a company. As an example, the tax court mentioned a listed stock company where, typically, all shareholders have a common interest in the economic development of the company; the tax authorities' interpretation would put the NOL carryforwards of all listed companies at risk.

The lower tax court also referred to the legislative history of the change-in-ownership rules, where the legislator described that an indication of parties acting in concert is present where a loss company is jointly controlled by the acquiring shareholders. Based on the legislative history, the lower tax court concluded that a group of acquirers pursuing common interests is present where several acquirers jointly work together to acquire their interests in the loss company and this group of acquirers has a joint controlling influence on the company after the acquisition. The joint controlling influence on the company can be demonstrated by vote control agreements, consortium agreements or other binding agreements. The decisive point in time where such agreements must be available is the time when the acquisition takes place. The mere possibility of jointly taking control of the company in the future is insufficient; it is relevant only whether the group of acquirers actually takes joint control of the company. The term "parties acting in concert" must be interpreted very narrowly to prevent a scenario in which every sale of more than 25% or 50% of the shares in a loss company to several acquirers in a transaction would lead to a partial or full forfeiture of the NOL carryforwards.

The lower tax court concluded that, even if the acquisition clearly had been coordinated between the acquirers in the case at hand, no facts had been presented to the court that substantiated the tax authorities' argument that, at the time of the acquisition of the shares in ABC-GmbH, additional agreements were in place between the acquirers to jointly control the company in the future. The coordinated and aligned acquisition of the shares could not be taken as an indication of future joint control of the company. As a result, the tax court dismissed the tax authorities' arguments.

The tax court decision is the first decision clarifying the definition of the term "parties acting in concert" for purposes of the change-in-ownership rules, and it provides valuable guidance for taxpayers. The tax authorities have appealed the decision to the federal tax court, and the appeal currently is pending.

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