

## **Remaining payable of company in liquidation should not result in cancellation of debt income**

Tax authorities' guidance provides long-awaited clarifications

The regional tax office of Frankfurt/Main issued a decree on June 30, 2017 on the tax consequences of the liquidation of a company that still shows a payable from its corporate shareholder in its final liquidation balance sheet. The decree confirms that the liquidation of the subsidiary should not result in cancellation-of-debt income and that the corporate shareholder's approval of the company's liquidation cannot be deemed to be a waiver of the receivable.

The decree, which is the result of a coordinated discussion at the state and federal level of the German tax administration, reverses the position of the tax authorities and clarifies an area that has been fraught with uncertainty. Previously, the tax authorities were of the opinion that liabilities that remain with the liquidating company following the sale of all of its assets leads to a taxable gain when the company is liquidated. Although the issue has been before the German courts, the federal tax court, in a decision dated May 5, 2014, declined to provide guidance on the tax treatment of the remaining liabilities of a company at the end of a liquidation process (see GTLN dated [June 20, 2014](#)); and the local tax court of Cologne, in a decision dated March 6, 2012, outrightly rejected the old position of the tax authorities that a taxable gain would be triggered.

The decree is based on a fact pattern where a loan was granted by a parent company to its subsidiary. The parent company approved the liquidation of the subsidiary, but did not waive the receivable. The decree states that the parent company's application to liquidate the subsidiary and its granting of approval of the liquidation cannot be considered a deemed waiver of the receivable – the subsidiary still is responsible for the debt. A deemed waiver could arise only if there is clear objective evidence that the creditor no longer intends to enforce its claim.

The decree also provides that:

- An excess of liabilities over assets in the final liquidation balance sheet of the company should not affect the obligation to show the liability in the balance sheet for German GAAP and tax purposes, nor should it lead to an impairment of the payable at the level of the debtor. The payable will be removed as a liability only if it can be presumed that the creditor no longer intends to enforce its claim.
- The existence of a qualified subordination agreement should not affect the above analysis if the subordination agreement includes a reference to a loan repayment out of "other available assets" of the company. If this language is not included in the agreement, the decree refers to section 5 (2a) of the Income Tax Code, according to which the payable no longer can be shown as a liability in the tax balance sheet (see GTLN dated [July 16, 2015](#)).
- Insolvency proceedings of the subsidiary should not affect the obligation to record the payable as a liability in its balance sheet.

### **Comments**

The decree provides welcome guidance to taxpayers and eliminates uncertainty in cases where the liquidation of a subsidiary still has a payable to its parent company (or where the payable is towards any other related party). However, potentially affected taxpayers should not explicitly cancel or waive a receivable before a liquidation process is terminated.

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