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German Tax and Legal News

Tax loss carryback possible after harmful share transfer during the relevant fiscal year

Lower court decision conflicts with MOF guidance

In a decision dated July 21, 2016, the lower tax court of Münster ruled that a harmful share transfer in the course of a fiscal year (FY) does not impact a carryback of a loss incurred in the FY of the transfer.

In the case before the court, the taxpayer had transferred 50% of his shares in a company during FY 2013, a year in which the company had incurred a loss. The taxpayer carried the entire loss incurred in 2013 back to FY 2012. Based on guidance issued by the tax authorities in 2008 on the use of losses following a harmful share transfer, the competent tax office took the position that the loss had to be calculated pro rata, with 50% of the loss incurred before the harmful share transfer being forfeited. The taxpayer appealed the decision to the court.

Under the general change-in ownership rules in German law, a direct or an indirect change in ownership of more than 25% but not more than 50% to one acquirer, related party or parties acting in concert generally results in a partial forfeiture of all tax losses that were not used until the harmful share transfer. Where there has been more than a 50% change in the direct or indirect ownership, all of the loss carryforward are forfeited. According to guidance issued by the tax authorities on the application of the loss transfer rules, if a harmful share transfer takes place during a financial year, a loss incurred until the date of the harmful transfer is (partially) forfeited.

The lower tax court of Münster did not agree with the tax authorities. The court confirmed that the wording of the law leaves open whether the use of losses is hindered by way of a loss carryforward or loss carryback. The court held, however, that the law aims to prevent the transfer of losses, i.e. to ensure that losses transferred are used by new shareholders. Hence, a loss carryback under which the losses are used by the same shareholders that economically born the losses cannot be covered by the change-in-ownership rule. The court further stated that its view is supported by decisions of the federal tax court which clearly distinguish between old and new "economic engagements" (a term used by the court) and allows a compensation of profit and losses incurred under the old economic engagement.

The court has allowed an appeal to the federal tax court.

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