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German Tax and Legal News

The transfer of shares by way of anticipated inheritance leads to forfeiture of losses carried forward

The Financial Court of Muenster (FG Muenster) had to decide whether the transfer of more than 50% of the shares in a GmbH by way of anticipated inheritance leads to the forfeiture of the losses carried forward in the sense of sec. 8c of the German Corporate Tax Act (KStG). In its ruling of 4th November 2015 (9 K 3478/13 F), the Financial Court of Muenster confirmed the forfeiture of the losses carried forward in such a case, after the responsible tax office had previously disregarded the contrary provision of the letter of the Federal Ministry of Finance (BMF) dated 4th July 2008, pursuant to which sec. 8c KStG does not apply to the transfer of shares by way of anticipated inheritance.

The following article discusses whether and how a tax payer/corporation should react in such cases. Moreover, it aims at giving an overview of the other options that should be considered when discussing share transfers by way of anticipated inheritance as means of estate planning.

I. Facts of the case (shortened):
The applicant, a GmbH, had a registered share capital in the amount of € 27.000,00. Approximately two thirds of the shares were held by a father, one third by one of his sons. In the relevant year 2008, the father - by way of anticipated inheritance - transferred a share representing more than half of the share capital to his son who already held shares in the company. The application of the German law rules pursuant to which the recipient of the respective donation would have been held to compensate the other legal heirs in the course of the distribution of the inheritance at a later time in the sense of sec. 2050, 2052 of the German Civil Code (BGB) was expressly excluded. After a tax field audit, the responsible tax office decided the losses carried forward to be forfeited because of the transfer of shares. It took the view that in order to qualify as transfer by way of anticipated inheritance, the transfer must come with the respective compensation obligations as foreseen in sec. 2050 BGB which may not be derogated. In the case decided by the Court, that provision of German law had however expressly and properly been derogated. The applicant raised an objection. In support of its objection, it contended that according to the letter of the Federal Ministry of Finance dated 4th July 2008, the transfer of shares by way of anticipated inheritance is not subject to sec. 8c KStG and that in the letter, no reference is made to sec. 2050 BGB. Due to that, a transfer of shares by way of anticipated inheritance should not lead to the forfeiture of the losses carried forward. However, the objection was considered unfounded, whereupon the applicant filed a suit to the Financial Court.

II. Decision
The court ruled against the applicant by confirming the tax office's decision, according to which the transfer of shares has led to a forfeiture of the losses carried forward. Contrary to what the applicant claims and contrary to the BMF letter's wording, sec. 8c KStG shall apply to such cases. An appeal is still pending at the Federal Financial Court ("BFH", Az: BFH I R 6/16). As regards the tax details cf. Deloitte Tax-Newsletter dated 21st April 2016.

III. Possible remedies and other options
The discrepancy between jurisdiction and administrative practices, the latter based on the letter of the Federal Ministry of Finance, causes legal uncertainty. The new draft letter concerning sec. 8c KStG (as of 15th April 2014) does not contain any relevant modifications with respect to the rules applying to anticipated inheritance (with these modifications being limited to limitations to close relatives, see Tz. 4). Thus, the discrepancy should continue to exist. The letters of the Federal Ministry of Finance are not legally binding upon the courts. The question rises, whether and how possibilities of legal protection can be guaranteed if the responsible tax office disregards a letter of the Federal Ministry of Finance.
Furthermore, there could be other options for the taxpayer that should be considered. Insofar one needs to distinguish between cases where shares have already been transferred (see subdivision 1 and 2) and cases of planned future shares transfers (see subdivision 3 and 4).

1. Disciplinary Complaint („Dienstaufsichtsbeschwerde“)
The so called disciplinary complaint is an informal legal remedy against the personal conduct of an official or a public sector employee. Its main target is to adopt specific measures against the responsible person. The disciplinary complaint does not lead to another decision concerning the substance of the case and is hence unsuitable as a legal remedy.

2. Appeal for subject-specific supervision (“Fachaufsichtsbeschwerde” or “Sachaufsichtsbeschwerde”)
The appeal for subject-specific supervision is an informal legal remedy which can be considered if the addressee of a decision or an official measure disagrees with the manner of handling the case, especially, if he considers the decision to be wrong. Its main target is achieving another decision concerning the substance of the case. Due to the general principle that an institution must comply with the rules which it itself has promulgated (see letters of the Federal Ministry of Finance), there might be a chance for the addressee to obtain a deviating, more positive decision concerning the substance of the case since the competent supervisory authority (normally “Oberfinanzdirektion”) should take the letters of the Federal Ministry of Finance into account.

3. Binding ruling
In case the shares have not been transferred, yet, and at least for as long as the Federal Financial Court (BFH) has not adopted a final decision in favor of the tax payer, obtaining a binding ruling in the sense of sec. 89 para. 2 of the General Tax Code (AO) should be considered. The binding ruling is - as the name suggests - mandatory for the fiscal authorities even if the binding ruling is illegal in favor of the tax payer. It therefore represents a suitable tool to avoid any unpleasant surprises.

4. Wrap-up and other legal strategies
The transfer of shares in a GmbH by way of anticipated inheritance has been frequently executed in recent years with the aim of benefitting from the tax relief in the sense of sec. 13a of the German Inheritance Tax Act which allows a tax-neutral capital transfer from one generation to the next. Today also, like then, income tax effects should be considered (e.g. sec. 8c KStG) before transferring shares. In any case, one should refrain from contractually excluding the application of sec. 2050, 2052 BGB. Moreover, and at least if and where relevant losses carried forward exist, a binding ruling should be obtained to have clarity as to whether the fiscal authorities intend to apply sec. 8c KStG.

A negative decision after filing for a binding ruling should not only be challenged by raising court action, but also by taking an appeal for subject-specific supervision into account in order to achieve a more favorable interpretation of the letters of the Federal Ministry of Finance. If unsuccessful, a short-term loss utilization before transferring the shares might be considered (sale-and-lease-back-models, transformations with “step-ups” or debt-waivers).

Since sec. 8c KStG requires a (legal) transfer, the rule should not apply in case of succession, so that it might be an option to structure the succession in the proper sense in a proactive way.

Consequently, even after the decision of the court discussed herein there is still a wide variety of possible actions, all of which should be analyzed prior to transferring shares.

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