

A large, illuminated glass dome structure, likely the Reichstag dome in Berlin, is the central visual element of the page. It is shown from a low angle, looking up, with the sky in the background. The dome's interior lights are visible through the glass panels.

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ECJ Decision in the STEKO Case

In a judgment dated 22 January 2009, the European Court of Justice has decided on the diverging entry into force of the half income rule for write-downs on interests in foreign and domestic corporations.

A German corporation (STEKO) held an interest of less than 10% in several foreign corporations. In 2001, STEKO wrote down these interests to a lower going-concern value. In line with the legal provisions these write-downs were not accepted by the tax authorities. The tax authorities justified this on the grounds that capital gains are tax-exempt under the half income rule and that therefore capital losses and write-downs to the lower going-concern value could not be deducted. As of the 2001 assessment period, no deductions could be made on interests in foreign corporations, while for interests in domestic corporations this rule only applied as of the 2002 assessment period.

The ECJ considered this difference in treatment of interests in foreign and

domestic corporations a restriction on the free movement of capital. With reference to the decision *Grønfeldt* (C-436/06, see German Tax Monthly February 2008), the ECJ stated that it was irrelevant that the discrimination only persisted for a limited period of time.

According to the court, the discrimination was not justified by the fact that interests in foreign and domestic corporations were subject to two different systems of taxation. While for interests in foreign corporations the new system exempting dividends and capital gains, but denying any write down on shares was already in effect as of the 2001 assessment period, the imputation system still applied for interests in domestic corporations. The application of different rules of taxation was in fact the discrimination. The ECJ referred to its decision *Rewe Zentralfinanz* (C-347/04, see German Tax Monthly May 2007) in which it decided that parent companies are in a similar situation whether they hold interests in foreign or domestic corporations.

In the case at hand, the discrimination could neither be justified by the coherence of the tax system nor the argument that the legislator has a certain discretion in drafting transitional provisions. The need to administer taxes effectively also offered no justification.

The decision of the ECJ is relevant for cases in which a write-down to the lower going-concern value on interests in foreign corporations took place in the year 2001. This applies to interests in EU-companies and companies located outside the EU alike.

Decisions of the Federal Tax Court on the Constitutionality of § 8 (4) KStG 1996

The Federal Tax Court commented on the change-of-control rules in § 8 (4) KStG 1996 (Corporate Income Tax Law) in two decisions. According to the change-of-control rules, it is a condition for a loss deduction that the corporation claiming the loss is identical to the corporation suffering the loss not only in legal but also in economic regard.

According to § 8 (4) KStG 1996, the economic identity was in particular lost if more than 75% of the shares were transferred and if the corporation afterwards restarted its business operations with predominantly new business assets.

The Business Tax Reform Continuation Act amended § 8 (4) KStG 1996 and determined inter alia that a share transfer is already deemed detrimental if more than 50% of the shares of a corporation are transferred.

In principle, this restriction was to apply from the 1997 assessment period onwards. If the loss of economic identity occurred for the first time in 1997, but before 6 August 1997, the application of the new rule was to begin in the 1998 assessment period instead.

In its judgment from 27 August 2008, the Federal Tax Court decided on a case in which the corporation lost its economic identity in February 1997. Corresponding to the legal provisions, the loss carryforwards which had been determined as per 31 December 1997 were not deductible in the year 1998.

The Federal Tax Court was of the opinion that the application rule was not impermissibly retroactive because no stricter taxation rules applied in the assessment period of the restructuring (1997), but only in the 1998 assessment period. The taxpayer's trust owing to past dispositions was only deserving protection to the effect that he would not be subjected to higher taxation for the assessment period of the disposition, the year of the restructuring (1997). The legislator was not, however, limited in its actions with regard to subsequent assessment periods. Thus, the application of the rule in 1998 did not qualify as an impermissible retroactivity.

In a further decision of 8 October 2008, the Federal Tax Court decided on a case in which the loss of the economic identity of the corporation (pursuant to the amended provision) had already taken place before 1 January 1997.

The Federal Tax Court stated that the application rule could violate the principle of equality of Article 3 (1) of the German Constitution.

Corporations which, pursuant to the amended provision, had already lost their economic identity before 1 January 1997 were not able to deduct their losses in 1997 pursuant to the application rule. On the other hand, corporations which had lost their economic identity for the first time in the year 1997 before 6 August 1997 were able to continue making use of a loss carryforward in 1997.

The Federal Tax Court could see no material reason for this unequal treatment. It therefore submitted the question of the constitutionality of the application rule to the Federal Constitutional Court.

Transferability of Losses in case of Corporate Mergers

The German Reorganization Tax Act 1995 stated that, in the case of corporate mergers, loss carryforwards could be transferred to the acquiring company under certain conditions. The business causing the loss had to be continued to a comparable extent for a period of five years following the date of the merger. In order to determine whether the operations had been continued, the extent of the business before and after the merger had to be compared. It was unclear what the relevant date was for this judgment and to what extent a lowering of the relevant criteria was permissible.

In a decision from 10 September 2008, the Lower Tax Court of Berlin-Brandenburg held that, contrary to the opinion of the tax authorities, the relevant extent of the business operations was not to be determined as the average during the loss phase before the merger, but as of the tax effective date of the merger. The Tax Court stated that the comparability with the company causing the loss no longer exists in the event that the original business operations decrease by over 50%. Since according to the Tax Court the 50%-rule is rebuttable, the taxpayer could disprove this assumption in the individual case. Criteria to determine the size of the business are the volume of sales and orders, actual assets and the number of employees.

The tax authorities have lodged an appeal with the Federal Tax Court against this decision. Whether or not the Fed-

eral Tax Court will uphold the position of the Lower Tax Court remains to be seen.

The decision applies for mergers which took place before the new Reorganization Tax Act entered into force. Loss carryforwards are generally not transferable to the acquiring company in the case of corporate mergers taking place after 12 December 2006.

Second Economic Recovery Plan: Approval by the Federal Council

On 20 February 2009, the Federal Council, the Upper House of the German Parliament (Bundesrat), approved the second economic recovery plan passed by the German Parliament (Bundestag) on 13 February 2009. The 50-billion EUR package, which we already discussed in the January edition of German Tax Monthly, contains a municipal investment program as well

as a lowering of the tax burden intended to strengthen the economy.

Employee Equity Participation Act: Approval by the Federal Council

On 13 February 2009, the Federal Council approved a law passed by the German Parliament on 22 January 2009 providing tax incentives for the participation of employees in the equity of companies (Mitarbeiterkapitalbeteiligungsgesetz). The intention of the act is to enable more employees to participate in the success of their company.

In particular, the maximum amount exempt from taxes and social security was raised from EUR 135 to EUR 360. The act is supposed to enter into force on 1 April 2009. More detailed information on the Employee Participation Act can be found in the October Issue of German Tax Monthly.

Imprint

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