BUSE.DE

Tax-Loss Carryfowards of Corporations

What is new? What should be done?

The German legislator has opened up new possibilities for corporations to continue to use tax losses in the event of a qualified change of shareholders. The intention is to eliminate obstacles to the capitalization of companies.

June 2017, Dr. Alexander Wolf

Background

An important downside to the acquisition of shares in a corporation (e.g. a stock corporation (AG), a limited liability company (GmbH) or a European company (SE)) is the imminent loss of unused losses under German tax law. In the event that subscribed capital, membership rights, equity rights or voting rights of more than 25 percent are transferred to an acquirer, this results in a pro rata loss of the unused losses of the corporation ("harmful acquisition of equity "). In regards to a transition of more than 50 percent, the losses are completely lost, unless the transfer of shares takes place within a group (so-called group clause) or the corporation has sufficient hidden reserves (so-called hidden-reserve escape).

The new law

The "Law for the Further Development of the Tax Loss Carryforward Allocation for Corporations" from December 20, 2016 creates **a further possibility to continue using losses** despite a harmful acquisition of equity with the introduction of § 8d of the Corporate Tax Act (KStG). Essentially, the following requirements must be met:

- **No change of business operations** since the establishment of the corporation or at least during the three years prior to application.
- Losses don't result from the period prior to the ending of business operations.

- The corporation must not be a parent company.
- The corporation must not be involved in a partnership.
- No assets below the fair market value may be brought into the corporation.

If these requirements are fulfilled, the tax office will, upon written request, establish a so-called **continuation-based loss carryforward** and disclose it separately. The application must be submitted in the tax declaration for the period of assessment in which the harmful acquisition of shares occurs. In addition to the corporate tax loss carryforwards, the trade tax losses are also affected by the new law in accordance with Section 10a Trade Tax Act.

The new regulations apply retrospectively from January 1, 2016. This means that an application may be submitted in accordance with § 8d of the Corporate Tax Act (KStG) in the case of a purchase of equity made in 2016.

Additional remarks

If, for example, a potential investor wants to know whether loss carryforwards are retained due to an application pursuant to § 8d of the Corporate Tax Act, he must, in the future, determine whether the business operations of the corporation have changed in a harmful way during the last three financial years.

According to the Corporate Tax Act, the concept of “business operation” is defined by “qualitative characteristics in an overall consideration”. The law mentions the following “qualitative characteristics” in a non-exhaustive list: Products, services, customer base, suppliers, markets and the qualifications of workers. Examples of changes to business operations are the discontinuation of business operations, the change of branches and the commencement of another business operation.

The law also introduces new challenges to the planning of arrangements that influence the business operations or structure of the corporation. Management must take into account that acquisitions, restructurings or the establishment of a corporate body with the participation of the corporation as a parent company can lead to a situation in which an application made pursuant to § 8d KStG will be invalid or the “last-identified” **continuation-based loss carryforwards** – even without a change of shareholders – will be lost in the subsequent period.

Conclusion

Corporate bodies should check whether they can file an application in accordance with § 8d of the Corporate Tax Act for the assessment period 2016.

Since the application is to be submitted in the tax return for 2016, it should be dealt with promptly.

In the context of transactions, it is necessary to examine whether the strict requirements of § 8d KStG (particularly with regard to harmful changes in business operations) are legally secure.

Changes in business operations, restructuring, acquisitions, the establishment of a corporate body with the participation of the corporation as the parent company, as well as the establishment of partnerships, are to be examined as to whether or not **continuation-based loss carryforwards** are affected.

Contact:

Dr. Alexander Wolf
E-Mail: wolf@buse.de | Tel: +49 69 989 7235-0

Web Version: https://buse.de/en/insights/tax-loss-carryfowards-of-corporations/