

PUBLICATION

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GERMAN FEDERAL TAX COURT CAUSES UNCERTAINTY IN RESTRUCTURING CASES

The Grand Senate of the German Federal Tax Court abolished the so-called "Restructuring Decree".

Over the past years, the German tax authorities supported companies in times of crises by waiving taxes based on an administrative order, the "Restructuring Decree". Taxes on non-cash income in cases of waivers of loans were not collected by the tax authorities, provided the waiver was intended to serve the restructuring of the business. This was deemed to be the case if the company had established a recovery plan. Over the last several years many companies which were at the brink of insolvency have benefitted from this widely-accepted practice. Binding rulings have been granted by the authorities based on the Restructuring Decree.

The Federal Tax Court now ruled that the Restructuring Decree violates the principle of legality of administrative action. If the lender of a company waives a loan, even in a restructuring scenario, the financial position of the company increases. Waiving taxes on profit generated upon such waiver is neither within the discretion of the tax authorities in general nor within the discretion of the Federal Ministry of Finance (BMF) which enacted the Restructuring Decree in 2003. The administrative order was based on economic and political grounds. Only the German legislature, however, can make such a decision. Since a similar law (Section 3 No. 66 of the German Income Tax Act) was abolished by the German legislature in 1998, the Court concluded that the German legislature had explicitly decided that a restructuring profit is subject to tax. German tax law does offer, under rather strict circumstances, the possibility of waiving taxes for the benefit of struggling companies on an individual basis. However, a general waiver such as the Restructuring Decree violates overriding principles of law.

However, the German tax administration will not be allowed to require companies that have benefitted from the Restructuring Decree to pay additional taxes; this is true, in particular, if binding rulings have been obtained from the competent authorities. Unfortunately, however, the question whether tax benefits granted under the Restructuring Decree would violate EU Law (unlawful state aid), remained unanswered as it had no relevance to the decision in the eyes of the German Federal Tax Court.

In any event, as the current situation is not satisfactory at all, the German legislature is now strongly encouraged to implement a new law which meets the requirements stated by the Federal Tax Court in its decision. This would remove the uncertainty which is not acceptable to companies in distress in Germany.

FOR FURTHER INFORMATION, PLEASE CONTACT: