



German Federal Tax Court: No tax shelter for profits arising from haircuts

Under German law, the waiver of a debt by a creditor results in a taxable profit for the debtor. The German Ministry of Finance ("MoF") had, however, issued a decree which nonetheless allowed such profits to be exempted from taxation. In a decision published on February 8, 2017 the German Federal Tax Court ("BFH") held that this ministerial decree constituted a breach of the principle of legality as the MoF was not authorized to grant the tax exemption without a legislative basis. This landmark ruling will have far-reaching effects for all businesses which are on the verge of insolvency.

Background

In 1997, the German Federal Parliament had abolished the then existing tax shelter for profits resulting from debt waivers. Following repeated criticism, the MoF in 2003 reintroduced the tax shelter as part of the so-called "restructuring decree" (Sanierungserlass), subject, however, to certain conditions. These required, inter alia, that the debtor was capable of regaining economic viability as a result of the haircut, and that the creditors were willing to support the restructuring of the debtor.

The BFH held that by creating a "structural correction of a statute", the MoF had exceeded its powers. The court also made it clear, however, that it does not object in principle to a tax shelter for profits resulting from a haircut, however, that this would require an amendment of the tax laws by the Federal Parliament.



**Consequences of the
decision**

:The decision may lead to many companies in financial difficulties being henceforth wound up rather than being restructured, with a substantial loss of jobs and tax revenues resulting from such measures.

It appears that if the tax authorities refuse to grant a tax exemption on an equitable and discretionary basis, any complaints against decisions refusing such an exemption will henceforth have little chance of success. Whether or not in turn the German tax authorities will be more lenient in their approach to granting such exemptions is an open question. And whether, when and if so, how, the German legislature will intervene in order to solve the problem also remains to be seen. In any case, a solution which is compatible both with German constitutional law as well as with EU subsidy law will certainly not be achieved within a short period of time.



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