



German Federal Tax Court dismisses Restructuring Circular

I. Background

The restructuring circular of the German Ministry of Finance from 2003 provides that income tax on a restructuring profit resulting from a debt waiver as part of a restructuring can be deferred and, after set-off against specific tax losses, finally waived by the German tax authorities. In practice, the restructuring circular has been a very important instrument to ensure the restructuring of a distressed company either in an out-of-court restructuring or via insolvency proceedings. Based on the restructuring circular, the German tax authorities have usually granted binding rulings in advance for the respective debt waivers.

II. Decision of the German Federal Tax Court

As announced last week, the German Federal Tax Court has now ruled in a decision of 28 November 2016 that the restructuring circular does not have a sufficient basis in the German tax law and may therefore no longer be applied.

The court did not comment on the likewise heavily discussed question whether the restructuring circular violates the EU state aid rules.

III. Implications on German Restructurings

German companies in a financial crisis cannot rely on the restructuring circular any more. This will result in substantial legal uncertainty in practice and will make future restructurings much more difficult or even impossible. Although tax authorities will remain entitled to grant a tax relief on a case by case basis due to personal equity reasons, it remains uncertain whether and to what extent tax authorities will issue rulings for such reliefs in advance.

IV. Possible Reaction of the German Legislator

Bearing in mind the upcoming German parliamentary elections in September 2017 and the possible violation of EU law, it remains to be seen whether and when the German legislator will introduce the basic statements of the restructuring circular into the German income tax acts. In that context also the competence for assessing the restructuring gain from a trade tax perspective could be transferred from the local municipalities to the tax authorities.

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