



BDO Seidman, LLP
Accountants and Consultants

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International Tax Alert

Subject:

2008 German Tax Reforms: Loss Carry-forward Limitation Rules

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For more information, please contact:

Jack Frame
BDO Seidman, LLP
330 Madison Avenue
New York, NY 10017
Phone: 212-885-8125
jframe@bdo.com

On August 21st, the German legislature approved earlier proposed tax reforms. Loss transfer rules are to apply to changes in direct and *indirect* ownership (previously only direct ownership).

Date/Timing

Scheduled to take effect on January 1, 2008

Affecting

Taxpayers holding direct or indirect interest in German entities with tax loss carry-forwards

Summary of Proposals

Loss carry-forward (NOL) limitation rules

Current law

Under the current law, the change of control in a corporate entity leads to a denial of the future use of loss carry-forward when (a) more than 50 percent of ownership is transferred directly and (b) the company continues its regular business activities with predominantly new assets. Indirect transfer of ownership does not affect the future use of an existing loss carry-forward.

New law

Effective January 1st, 2008 the new rule will only consider the change in the ownership, both direct and *indirect*. The business assets test will no longer be pertinent. Limitation of carry-forward losses will be examined by two methods:

1. Pro-rata loss disallowance will be used when a transfer of shares or voting rights is between 25 percent and 50 percent;
2. Full loss disallowance will take effect in the case of a transfer of shares or voting rights in excess of 50 percent.

In addition, the new rule will take into consideration whether the shares or voting rights are transferred to a single acquirer or to related persons of the acquirer within a five-year period. Under the related party definition, all persons with “equally phased objectives” will be considered as sole purchaser, thus any ownership change within the worldwide group will be considered as one entity. For example, if U.S. Company, which owns a German loss company as forth-tier subsidiary interpositions a U.S. Holding Company to the same group, the German loss carry-forward is forfeited. Because of this new rule, even the reorganization of the top tier companies of a group can prevent the German group companies from using their tax loss carry-forwards. At this time the rules are not clear as to whether the “shortening” of corporate chain will also be harmful.

Any future company reorganizations which include German subsidiaries must keep in mind whether the German subsidiaries’ tax loss carry-forwards are involved. Any tax planning regarding indirect ownership changes should be done prior to December 31, 2007 to avoid application of loss transfer limitation rules.

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