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CJEU decision on the compatibility with State aid rules of the German "Sanierungsklausel" on the carry forward of tax losses by ailing companies

State Aid – Germany - Tax loss carryforwards – Sanierungsklausel - Selectivity – Reference System – Competition

On June 28, 2018, the Court of Justice of the European Union (CJEU) rendered its decision in the Heitkamp Bauholding case (C-203/16) regarding the compatibility with EU State aid rules of German legislation, which under certain conditions allows a company in financial difficulties to carry forward tax losses despite changes in its shareholder structure (so-called "reorganization clause" or "Sanierungsklausel"). In line with the Advocate General's opinion, the CJEU decided to annul the European Commission's decision that such legislation constitutes State aid, arguing that the reference system identified for the purpose of the selectivity analysis is incorrect.

Background

On January 26, 2011, the European Commission issued a final decision (2011/527/EU) concluding that the German "Sanierungsklausel" amounts to unlawful State aid, incompatible with the internal market. Under German Tax Law, companies may carry-forward tax losses indefinitely, unless a significant change in their shareholding structure occurs. However, based on a decree issued in 2003, which was further implemented into German law in 2009, certain companies in financial difficulties were allowed to carry-forward tax losses despite changes in their shareholder structure, in situations where the restructuring aimed at preserving the economic viability of the ailing company. In the Commission's view, this exception conferred a selective advantage on the companies benefiting from it, without this difference in treatment being justified. As a consequence, the Commission ordered Germany to withdraw the unlawful scheme and to recover the aid.

In response, the German Ministry of Finance suspended the application of the restructuring clause, denying the benefit of the regime to Heitkamp Bauholding GmbH ('HBH'), a company

which would have otherwise qualified. HBH therefore brought an action before the General Court of the European Union, seeking to annul the Commission's decision. After the General Court dismissed the action as unfounded in February 2016 (T-287/11), HBH appealed to the CJEU, arguing that both the Commission and the General Court had erred in identifying the rule governing the forfeiture of losses in the event of changes to a company's shareholding structure as the relevant reference system.

The CJEU decision

After confirming the admissibility of the application in a detailed analysis, the Court recalls the four conditions that must be fulfilled for a national measure to be classified as State aid, i.e. there must be (1) an intervention by the State or through State resources, which (2) is liable to affect trade between Member States, (3) confers a selective advantage on the recipient, and (4) distorts or threatens to distort competition. As regards the selectivity criterion in particular, the Court further underlines the necessity to first identify an "ordinary" tax system, before assessing whether the tax measure at issue constitutes a derogation from that system. In this respect, it should be considered to what extent the measure differentiates between taxpayers that are in a comparable situation, in the light of the system's objectives. However, the Court also states that a difference in treatment may be justified, if this flows from the nature or the general structure of the system itself. Referring to settled case law, the Court finally points out that the selective character of a measure should be assessed as regards the effects produced, rather than the objectives pursued and therefore independently of the regulatory technique implemented. Nevertheless, the fact that only taxpayers satisfying certain predefined requirements may benefit from the measure does not, in itself, make it selective.

In light of those considerations and in accordance with the Advocate General Wahl's opinion in the case at hand, the Court concludes that the selectivity of a tax measure cannot be assessed on the basis of provisions that have been artificially taken from a broader legislative framework. In that respect, the Court further notes that the restructuring clause's effect is to define a situation falling under the general loss carry-forward rule. As a consequence, the General Court, by excluding the general rule of loss carry-forward from the relevant reference framework in the case at hand, defined the latter too narrowly.

The Court therefore rules that the European Commission's decision 2011/527/EU is to be annulled, without it being necessary to further examine whether the German rules are selective, or constitute a derogation to the reference system.

EU Tax Centre comment

After the suspension of the restructuring clause in 2011, the CJEU decision is likely to constitute a welcome development for taxpayers, should the German Ministry of Finance decide in favor of its reintroduction. However, it remains to be seen how the European Commission will follow-up on the CJEU's conclusions, and it cannot be precluded that the Commission will consider the possibility of a new State aid investigation, based on a revised selectivity analysis. Nevertheless, the CJEU decision also provides some clarity on the definition of a reference system and of a selective advantage related to State aid.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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