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Germany's Government plans Mitigation of Loss Limitation and Interest Ceiling

In the coalition agreement signed at the beginning of last week, Germany's new Government announced significant changes *inter alia* to the loss limitation and the interest ceiling.

Loss Limitation

Since 2008, a corporation forfeits its unused losses in part (*pro rata*) if more than 25 percent of the shares in the corporation are transferred (directly or indirectly) to a single shareholder (or a group of shareholders with the same interests) within a period of 5 years (a so-called "harmful acquisition"). Moreover, a transfer of more than 50 percent of the shares leads to a complete forfeiture of all losses carried forward.

The Government intends to mitigate the loss limitation:

- Corporations shall be allowed to carry forward unused losses after a harmful acquisition up to the overall amount of hidden reserves in business assets which are subject to tax in Germany.

- The restructuring privilege shall be made permanent. This exception from the loss limitation rule for acquisitions made to rescue troubled companies was already introduced earlier this year: A corporation is allowed to maintain its losses, if its shares are acquired to avoid insolvency and to conserve the essential business structures of the corporation. This restructuring privilege was limited to acquisitions in 2008 and 2009.

- The coalition is considering the introduction of an affiliated group exemption, whereby the intra-group transfer of shares in a loss company would no longer be subject to the loss limitation. This would greatly facilitate internal reorganizations of groups with loss companies. Under current law, intra-group transfers are just as harmful as transfers to a third party.

Interest Ceiling

German tax law limits the deductibility of a taxpayer's net interest expenses to 30 percent of the taxable EBITDA. However, if the net interest expense does not exceed a minimum threshold, taxpayers may deduct net interest expenses irrespective of their taxable EBITDA.

The coalition parties intend to mitigate the interest ceiling:

- Taxpayers shall be allowed to carry forward “unused” taxable EBITDA to tax years with higher net interest expenses. This would help taxpayers with volatile EBITDAs.

- The increase of the minimum threshold shall be made permanent. The minimum threshold was already raised from € 1 million to € 3 million, but limited to the end of the tax year 2009.

Implementation

The coalition intends to implement these changes as early as January 1, 2010 as part of an emergency program to remove economic growth barriers quickly and effectively.

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If you have any questions, please feel free to contact J.F. Daniel Weyde (jweyde@cgsh.com) or Volker Junge (vjunge@cgsh.com) at the Frankfurt office of Cleary Gottlieb or any of our partners and counsel listed under "German Practice" under the "Practices" section of our website at http://www.clearygottlieb.com.

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