Breaking Tax News

Tackling taxes

ECJ: Mandatory Absorption of Losses Not Subject to Capital Tax

If a shareholder gives the commitment to absorb the company's losses before the losses were sustained, the loss coverage does not trigger capital tax (ECJ 1 December 2011, C-492/10, Immobilien Linz).

Legal Opinion in Austria So Far. After an ECJ judgment from 1990 (C-38/88, Siegen) the Austrian Administrative Court (VwGH) was of the opinion that the absorption of losses is not subject to capital tax only in cases where a profit and loss transfer agreement was concluded before the losses were sustained. A single commitment to cover the losses without such an agreement should not be sufficient (e.g. VwGH 30 March 1998, 97/16/0331). This jurisprudence has also been practice of tax authorities. The Tax Court of Appeals (UFS) had doubts if this interpretation is in line with the EU Capital Tax Directive (2008/7/EC) and referred the case to the ECJ.

ECJ. The ECJ held that the decisive criterion for the liability to pay capital tax is **not the nature of the obligation** to absorb losses – by the means of a profit and loss transfer agreement or a single commitment –, **but the time the shareholder enters into this commitment**. If the shareholder has entered into the obligation to absorb the company's losses before the losses were "sustained" or "recorded", the losses will automatically be passed on; thus, the company's economic activity will not affect its economic potential. In such circumstances the charging of capital tax upon the absorption of the company's losses is not justified, since there is no increase in the company's assets.

Conclusion. With this judgment the ECJ rejects the narrow legal view of the VwGH. The nature of the obligation to cover losses is not decisive for the tax liability. All that counts is the time the shareholder enters into the commitment. In the reasoning of the ECJ, however, the question remains open which time is exactly meant by the wording "before the losses were sustained" or "recorded". In the case at hand the shareholder had already entered into the obligation to absorb the company's losses before the beginning of the year the losses were expected in. Therefore, the obligation was certainly undergone into in time and the actual loss coverage must not trigger any tax. **Whether entering into the commitment during the loss year would also be sufficient, remains unclear.** To avoid the charging of capital tax in case of loss absorption by a shareholder, the commitment to cover losses should be given **before the beginning of the year** for which the losses are expected.

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