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update

Banking & Finance

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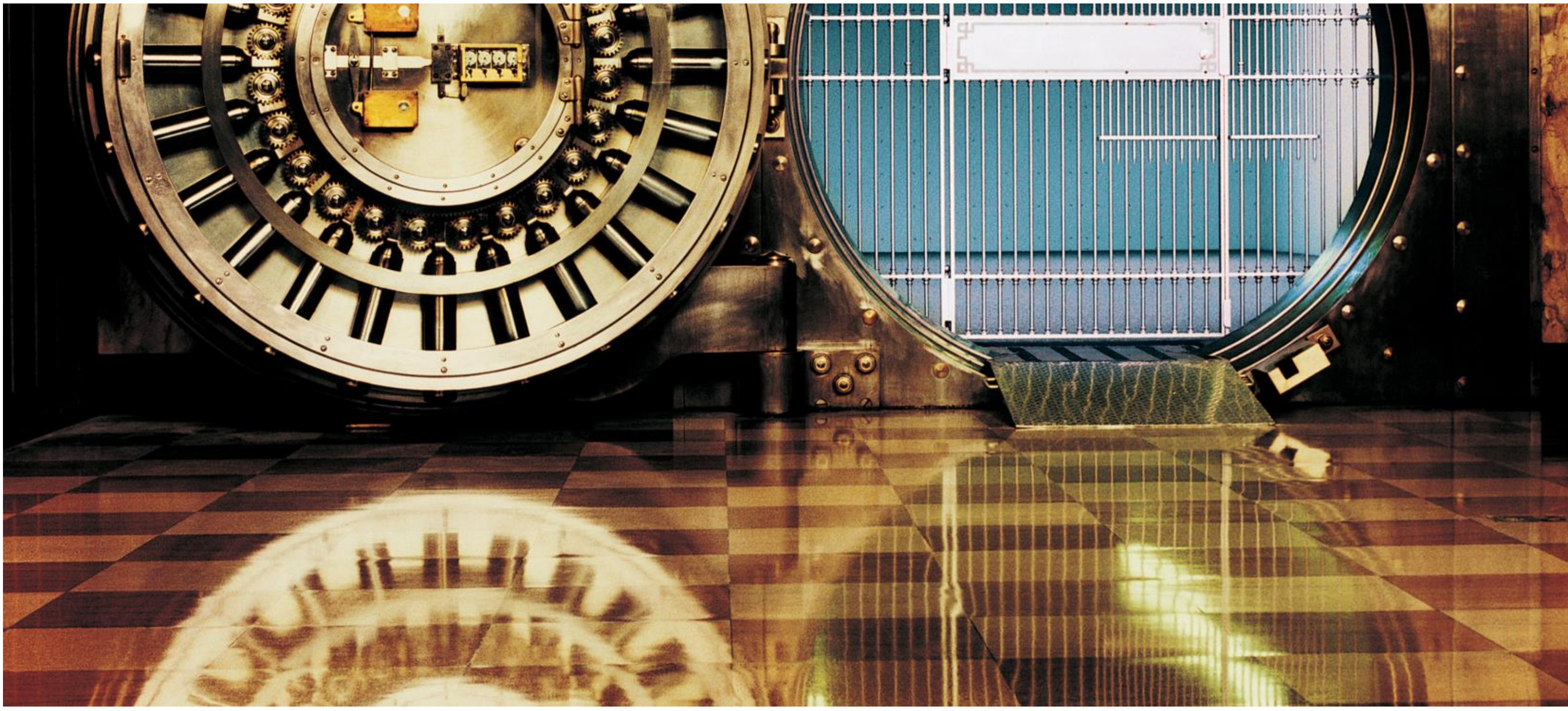

Contents

Editorial

Dear readers,

We are pleased to welcome you to a new, information-packed edition of our Update Banking & Finance. The articles selected are all of practical relevance and focus on the latest developments and case law in the areas of banking, finance and capital markets law.

The article on LIBOR ("London InterBank Offered Rate (LIBOR) – The beginning of the end of a reference rate", page 5) is of particular interest for our finance practice. The announcement by the Financial Conduct Authority (FCA) that it will not require banks to support LIBOR after the end of 2021 creates new challenges for parties to loan agreements. Loan agreements based on LIBOR which have terms beyond 31 December 2021 may need to be amended with respect to the LIBOR provisions they contain. Any new loan agreements formed will need to contain an alternative provision. The article also examines the background and motives of the FCA along with alternatives to LIBOR. This is an important issue that deserves your attention.

With respect to regulatory law, our new Update focuses on mandatory licences for investment intermediaries. The German Federal Financial Supervisory Authority (BaFin) has confirmed the applicability of the exception under section 2 para. 6 no. 8 of the Banking Act (KWG) to investment intermediaries within the meaning of section 34f of the Industrial Regulation Code (GewO) that transmit customer orders via a chain of investment intermediaries. Under certain conditions, these intermediaries can now operate with a "small" licence as defined in section 34f of the GewO when brokering fund units/shares. Our article examines BaFin's established administrative practice, particularly regarding extension of the exception to a multi-person relationship rather than the typical three-person relationship ("BaFin greases the chain of investment intermediaries – marketing of funds possible with 34f license", page 8).

Our third article relating to capital markets provides an update on the draft Regulations published by the European Commission on facilitating cross-border distribution of investment funds and boosting the Internal Market ("When good intentions fail to deliver", page 10). The European Commission runs the risk of defeating its own objectives here. This draft legislation abandons the liberal approach taken by BaFin in its administrative practice around the pre-marketing of AIFs. Pre-marketing and the subsequent decision to acquire an investment in a fund would be regarded as distribution activities under the new draft measures, and would lead to new requirements and challenges related to distribution notification. Developments between the scheduled enactment of the legislation in May 2019 and implementation by May 2021 will need to be followed carefully so that the relevant parties can respond appropriately and in good time to any potential constraints on how investors are approached.

Our case law overview features two articles on issues involving credit and insolvency law.

The topic of "negative interest" has been addressed in two court judgments since our last article in our December 2017 edition of Update Banking & Finance. We focus first of all on the applicability of the law on loan agreements to deposits, before examining the rejection of negative interest as a guiding statutory principle of loan agreement law. Given its major practical relevance and the requirements related to the introduction of negative interest in existing and new agreements via general terms and conditions, we strongly recommend reading this article ("Negative interest – current case law", page 12).

Lastly, this Update Banking & Finance is rounded off by an article on tax exemption of recapitalisation profits ("New developments on the taxation of recapitalisation profit", page 14). Although the new legislation does not apply yet, we have set out some tips for practitioners along with options for the relevant taxable entities. Further developments around taxation of recapitalisation profits will need to be monitored going forward. The relevant parties should consider in particular whether the current EU reservation will be lifted following approval by the European Commission, with the new regulations then applying.

We hope you enjoy reading this edition of Update Banking & Finance. If you have any comments or questions, please feel free to contact our authors or other partners and lawyers in the relevant practice area.

We are pleased to be able to provide you with a further exciting and interesting selection of articles in our latest Update Banking & Finance.

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Finance

London InterBank Offered Rate (LIBOR) – The beginning of the end of a reference rate

27 July 2017 could go down in history as the day which signalled the end of LIBOR as the world's most important reference rate. The chief executive of the Financial Conduct Authority (FCA) explained in a speech that market participants should aim to replace LIBOR with alternative reference rates at the end of 2021. The FCA's decision raises a number of issues which will particularly concern the contractual parties of loans, derivatives and bonds over the next few years. Interest is primarily focused on identifying alternatives and the contractual aspects of ongoing and existing contractual relationships.

Background and motives of the FCA's approach

Manipulation scandals in the recent past have already highlighted LIBOR placing it at the attention of a broader public. The FCA's current decision was due to the fact, however, that the determination of LIBOR was not based at least partially on any real transactions. The virulence of a non-existent market becomes clear if we bear in mind that LIBOR is determined by requesting refinancing interest rates on a day-to-day basis from a panel of banks. For one of these refinancing interest rates determined on a daily basis, i.e. for the combination of a currency with a specific term, according to the FCA, there were only 15 relevant transactions in the entire 2016 calendar year.

Despite the attested partial absence of a functioning market for unsecured inter-bank loans, LIBOR continues to be applied virtually in full in the contractual documentation of loans, bonds and derivatives. Current estimates from March 2018 show, for example, that deriva-tives and loans with a value of approximately 200 million US dollars are based on LIBOR. It, therefore, becomes apparent that there is a need for a sufficient transition period to potentially replace LIBOR. The FCA has set out the period up until the end of 2021 in this respect.

Alternatives to LIBOR

Work carried out by the Financial Stability Board (FSB) can be used to identify possible alternatives to LIBOR. The FSB already analysed reform initiatives in 2014 and 2017. The FSB first recognised the need for different reference rates and for reference rates which do not factor in a credit risk (risk-free reference rate or RFR). These RFRs are suited in particular for numerous derivatives. Special groups in a number of countries have since been identifying or developing suitable RFRs. In England for example, a reformed version of the Sterling Over-night Index Average (SONIA) has been published since 23 April 2018. The Secured Over-night Financing Rate has been determined for United States dollar since April 2018 and a new ECB unsecured overnight rate, called ESTER (euro short term rate) will be published before 2020.

Irrespective of an ongoing specification of RFRs, it is not possible to directly transfer them to financial products hitherto based on LIBOR. LIBOR and the RFRs currently being discussed have very different characteristics. LIBOR is thus determined for different time periods and at the beginning of an interest period. Conversely, RFRs are determined retrospectively on the basis of concluded transactions over-night and generally refer to short time periods. Thus, it is already clear in the event LIBOR is discontinued that it cannot be replaced by an equivalent RFR.

Challenges for the contractual parties to a loan agreement

Parties to a loan agreement based on LIBOR with a term which extends beyond 31 December 2021 should pay greater attention to this issue. This also applies to existing agreements as well as new agreements to be concluded. The particular challenge is that the agreement should sufficiently cover the risk of LIBOR potentially being discontinued. At the present time, this is generally not the case.

Model agreements from the Loan Market Association (LMA) can be used as an example for drafting usual market interest clauses. In accordance with international practice, a floating interest rate consists of a reference rate and the margin. If the reference rate cannot be determined, model agreements usually have several fallback solutions, ranging from using interpolated or historic interest rates to obtaining quotations from reference banks explicitly appointed for this purpose. However, none of these options provide a viable or satisfactory solution in the event the reference rate is permanently discontinued. Reference to a historic interest rate transforms a floating interest-bearing loan into a fixed interest-bearing loan. Continuously obtaining quotations via reference banks also causes practical concerns since the FCA's current approach shows that there is only a limited willingness to submit such quotations.

With regard to existing loan agreements the question thus arises of how to deal with this risk. Contractual parties can easily amend a loan agreement by adapting interest clauses where necessary. However, as the discussion about RFRs has not yet got down to the specifics, a change will only be displayed if there is a legal certainty with regard to replacing LIBOR and calculating alternative interest rates. Market participants are advised to first get an overview of which agreements and which contractual provisions are affected by this topic.

There is a similar need for such provisions in new contracts. With a lack of any clear alternatives to LIBOR, it must first be noted that agreements will continue without restriction to refer to usual market reference rates. This, of course, directs attention to the robustness of the above-mentioned contractual fallback solutions. In individual cases, these could possibly provide temporary protection, but this would have to be analysed in more detail. In addition, including clauses which subject supplementary agreements to less stringent conditions is recommended. For example, exchanging the reference rate in loan agreements should no longer require the consent of all the lenders, but only a majority of the lenders. The advantages of such a clause mainly depend, however, on the specific position of the contractual party or on the facts of the matter, so it is not possible to give any general recommendation.

From the lender's perspective, there is also the question of whether any necessary exchange of the reference rate can be carried out using an interest adjustment clause. This is the lender's unilateral right to specify performance with which he may request an adjustment to the interest rate. An interest adjustment clause agreed for an individual agreement may certainly be beneficial in such situations. In legal terms, these clauses can be qualified as general terms and conditions which must satisfy the requirements of section 307 ff. German Civil Code. Case law lays down restrictive requirements and among other things requires sufficient transparency in drafting agreements. This transparency, which among other things relates to the possible effects of an interest adjustment, directly depends on the current debate about replacing LIBOR and drafting agreements. The current debate about alternative reference rates and the requirements of case law provide the guideline for drafting such clauses.

Summary

The FCA's announcement not to want to oblige banks to apply LIBOR after 31 December 2021 has attracted and continues to attract a lot of attention. Even if it is not certain whether LIBOR will be discontinued in 2022, preparations for replacing the worldwide reference rate are in full swing. It is crucial for parties to loan agreements based on LIBOR with a term extending beyond 31 December 2021 to address this issue. Apart from taking stock of the agreements affected by this topic, it is advisable to analyse the respective contractual provisions which will be affected if the reference rate is discontinued. Contractual fallback solutions deserve special attention in the context of new agreements. In individual cases, these could at least provide temporary protection. Depending on the ongoing specification of alternative reference rates, interest adjustment clauses could also be beneficial.

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Supervisory Law

BaFin greases the chain of investment intermediaries – marketing of funds possible with 34f license

The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, “BaFin”) has confirmed the applicability of the exemption under section 2 para. 6 (1) n°8 of the German Banking Act (Kreditwesengesetz, “KWG”) to investment intermediaries within the meaning of section 34f of the German Commercial and Industrial Regulation Code (Gewerbeordnung, “GewO”) that transmit customer orders via a chain of investment intermediaries. The “small” license within the meaning of section 34f GewO suffices.

Background

Investment brokerage (Anlagevermittlung) is a financial service requiring a license under KWG. With respect to the marketing and distribution of fund units and fund shares, the “small” license defined in section 34f of the GewO suffices in terms of the exemption set out in section 2 para. 6 (1) n°8 of the KWG, provided that

– the entity provides exclusively investment advice and investment brokerage between customers (i.e. investors) and specific – exhaustively listed – undertakings (e.g. investment companies, banks, etc.),

– such financial services relate to specific – exhaustively listed – financial instruments (e.g. fund units or fund shares), and

– the entity obtains neither ownership nor possession of customer funds or shares.

Investment brokerage is defined as brokering of business involving the purchase and sale of financial instruments (cf. section 1 para. 1a (1) n°1, KWG). Providing brokering means, inter alia, transmission of the customer’s order as a messenger to the person whom the investor actually wants to do a deal with. By transmitting the customer’s order within a chain of investment intermediaries, each link in the chain falls within the scope of investment brokerage.

So far, the published BaFin guidance comprises the typical three-person relationship

Pursuant to the written BaFin guidance published in its notice regarding the exemption of investment intermediaries dated November 2017, the activity of investment brokerage “is rendered by transmitting the customer’s order related to the purchase or sale of financial instruments as a messenger. The exemption applies where such messenger activity is carried out between the customer (investor) and an undertaking within section 2 para. 6 (1) n°8 (i), KWG” (cf. point 1).

In this guidance, BaFin describes the basic idea thus: transmission takes place directly between the investor and the investment company. This is the typical three-person relationship comprising the investor, the intermediary and the investment company. The guidance is silent on whether multi-person distribution structures (i.e. chains of investment intermediaries) fall within the scope of the exemption.

Therefore, it is disputed amongst scholars whether the exemption covers situations where the intermediary is not the direct link between investor and investment company but transfers the customer’s order via another intermediary to the investment company. In practice, such chains of investment intermediaries are very common.

New statement by BaFin: the exemption also covers a multi-person relationship

In its statement dated February 16, 2018 (reference: GZ: EVG 1-QF 21000-2017/0188), BaFin confirmed the applicability of the exemption to multi-person relationships. In these cases, transmission between the investor and the investment company is via a second, third (etc.) intermediary:

"Section 2 para. 6 (1) n°8, KWG does not only cover the direct receipt and transmission of customer orders relating to the purchase or sale of finance instruments within the meaning of section 2 para. 6 (1) n 8, KWG, but also all service providers transmitting such a customer order via a chain of intermediaries to an undertaking – listed in section 2 para. 6 (1) n 8 lit. a)-e), KWG – the investor wants to do the deal with. As the activity of each intermediary within such a chain qualifies as investment brokerage within the meaning of section 2 para. 6 (1) n°8, KWG, each intermediary requires a license for its activity pursuant to section 34f, GewO."

BaFin's approach is consistent with the purpose of the law. The ratio legis of the exemption is not focused on how many distribution entities are involved between investor and investment company. Pursuant to the legislator's intention, fund units and fund shares are extensively standardized and, in any case, regulated products. The mere transmission of a purchase order or sales order does not involve particular risks. Therefore, the transmitting entity is not carrying out a regulated activity within the scope of the KWG (cf. Bundestag-Drucksachen 13/7142, p. 71; 16/4028, p. 91).

Conclusion

The BaFin statement supplements the guidance notice regarding the exemption of investment intermediaries dated November 2017. We welcome the clarification made with regard to chains of investment intermediaries. The statement provides legal certainty for common market distribution structures.

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Capital Market Law

When good intentions fail to deliver

Reaching investors made more difficult in Germany as a result of the European Commission's draft Regulation on facilitating cross-border distribution of investment funds

The European Commission wants to facilitate cross-border distribution of investment funds and by doing so boost the Internal Market. It published two draft Regulations in this regard on 12 March 2018.[1]

In terms of reaching institutional investors in Germany in particular, the draft legislation may well lead to a reversal of existing practice and end up defeating its own intention by making it more difficult to address this group.

Pre-Marketing

In Germany, the administrative practice of the Federal Financial Supervisory Authority ("**BaFin**") has allowed investment management companies to approach institutional investors with prospectuses or terms and conditions of investment at the draft stage in the case of special AIFs. This pre-marketing is standard practice with funds designed for institutional investors. It allows interest among investors and acceptance of the proposed terms to be established without the expense of obtaining a distribution license or preparing the final documentation. This initial contact is not deemed to be marketing and thus does not trigger any notification obligations. Even if an investor then decides to acquire an investment, this does not qualify as distribution activity (*BaFin*, FAQs on the marketing and acquisition of investment assets in accordance with the German Investment Code (KAGB), ref.: WA 41-Wp 2137-2013/0293, dated: 13 July 2016).

The legislation now being proposed jeopardises this liberal approach.

– First of all, it would no longer be possible for draft offer documents to be given to investors at the pre-marketing stage. Using drafts will be treated as a distribution activity that triggers notification obligations. However, it will not be possible to use draft documents to gain a distribution license or for distribution notification purposes. Any pre-marketing activity using drafts would be impossible in practice. Pre-marketing could then only take the form of providing general information on investment strategies or concepts. Gauging investor interest in a specific fund product, which is currently the purpose of pre-marketing, would no longer be possible.

– Secondly, the decision to acquire an investment in a fund following pre-marketing activity would be deemed a result of distribution activity under the draft legislation. This would force non-German fund providers in particular to undergo a licensing process, which would be particularly cumbersome and expensive for third countries.

[1] "Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC of the European Parliament and of the Council and Directive 2011/61/EU of the European Parliament and of the Council with regard to cross-border distribution of collective investment funds" and "Proposal for a Regulation of the European Parliament and of the Council on facilitating cross-border distribution of collective investment funds and amending Regulations (EU) No 345/2013 and (EU) No 346/2013".

Requirements for distribution notification

The draft legislation aims to create uniform requirements for EU-wide distribution via passporting notifications. Marketing documents should be identifiable as such, should present the risks and rewards, and should be fair, clear and not misleading. The last point, in particular, is likely to require content checks on distribution notifications and marketing documentation by the regulatory authorities. Up until now, checks on marketing documentation have been limited to ensuring that all the information required under Article 23 of the AIFM Directive is provided. Any review of the content of marketing documents would, in particular, be a new requirement for AIFs not subject to detailed product regulation or presentation requirements, such as the Luxembourg Reserved Alternative Investment Fund (RAIF) or a German AIF under section 282 of the KAGB. This creates uncertainty around the required level of documentation and could delay or prevent distribution.

Withdrawal from cross-border distribution

There is nothing to prevent an AIF being withdrawn from cross-border distribution, thereby avoiding the associated administrative obligations and costs. Under the draft legislation, however, any withdrawal would only be permissible if the investment fund has no more than ten investors in the relevant member state, who overall hold less than 1% of the assets under management. Many special AIFs will probably be unable to meet these requirements, particularly with regard to the investment threshold. Withdrawal from distribution is not then possible. The investment fund must continue to meet the ongoing requirements and bear the costs. This situation could make cross-border distribution more difficult.

Summary:

EU legislators run the risk of delivering the opposite of what they set out to achieve. BaFin's administrative practice could no longer be tenable in its present form if the draft legislation is enacted without modifications. It would be more difficult to market products to investors in Germany. That also applies to German AIFs, as a result of the restrictions on pre-marketing, but in particular to foreign AIFs on account of the other aspects. For foreign AIFs especially, the barrier to distribution in Germany – which has always been seen as high – would be raised even further.

The legislation is scheduled for enactment in May 2019 and would then be implemented in full by May 2021. Both foreign and German AIFs, their investment management companies and distribution partners should follow developments closely and adapt the way they approach investors in Germany accordingly.

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Jurisdiction

Negative interest – current case law

The topic of "negative interest" is still of great relevance for banking practice. There are currently no serious signs of a change in interest policy at the European Central Bank (ECB). Since our last contribution on negative interest (see Update Banking and Finance December 2017) the topic has been addressed in two decisions in case law. This has also led to the legal discussion becoming more intense.

Applicability of loan facility law

In its decision of 26.01.2018 (case no. 4 O 187/17) Tübingen Regional Court decided whether and how negative interest on demand deposits, time deposits and fixed-term deposits can be agreed. Thereby it held the view that both time deposits and fixed-term deposits have to be treated as customer loans to the bank within the meaning of section 488 German Civil Code because of their (minimum) terms. Demand deposits, i.e. in particular unrestricted overnight deposits with daily availability without notice period, are on the other hand to be classified as an irregular form of custody within the meaning of section 700 (1) German Civil Code. However, here as well as the provisions on the loan facility pursuant to section 488 German Civil Code will also apply. As a rule in the case of deposit transactions there is no true custody agreement where the interest of the customer in custody is in the forefront.

No negative interest as statutory rule

Therefore the law on loans is applied to deposits either directly or through section 700 (1) German Civil Code. Tübingen Regional Court holds the view that the law on loans does not include any remuneration duty of the lender. This would rule out the levy of negative interest. The court did point out that there is no statutory definition of interest, but by referring to the Federal Court of Justice the decision did assume that loan interest generally "is understood to be the remuneration independent on profit and turnover and dependent on term to be paid in monetary form or in other acceptable forms for the possibility of using capital". The transfer from a positive or zero interest to negative interest would therefore lead to a reversal of the payment obligations, thus changing the character of the contract. Negative interest would lead to the bank customer being obliged to pay a fee to the bank in addition to handing over of the funds, contrary to section 488 German Civil Code.

Munich Higher Regional Court comes to the same conclusion in its decision of 11.01.2018 (case no. 23 U 1783/17): In another context (i.e. interest for the default of repayment of profit participation certificate capital) the Senate states that there is no negative interest. The basic interest rate which in a few cases is cited in legal commentaries as an example of a statutory (potentially) negative interest rate is purely an arithmetical value. A custody fee which would de facto be constituted by such negative interest is in this view not covered by the statutory model of the law on loan facilities. However, this does not alter the fact that such a fee can be agreed in an individual contract.

Agreement of negative interest in general business terms and conditions

The decision of Tübingen Regional Court relates to the agreement of negative interest in general business terms and conditions. Because of the departure from the statutory model of section 488 German Civil Code the agreement of negative interest in this way would definitely be invalid for existing agreements pursuant to section 307 (3) sentence 1 German Civil Code as read with (2) no. 1, (1) sentence 1 German Civil Code.

The introduction of a negative interest rate is not permitted either via a floating interest clause – in the specific case there was one in the individual customer contracts – as such unilateral right to determine interest is subject to the principal agreement of the parties involved. However, if there is not yet a reference to negative interest in the original contract the legal agreement of the parties involved must be interpreted to the effect that no such negative interest should be covered. Thereby the term "floating/variable interest" does not cover a duty of the customer to pay a fee.

Furthermore, according to the Regional Court, such a clause is unclear within the meaning of section 305c (2) German Civil Code and thus to be construed against the party using the clause that no negative interest is covered. Moreover, such an interest determination option constitutes a surprising clause within the meaning of section 305c (1) German Civil Code – at least for existing contracts.

Consequences for practitioners:

The difference drawn by Tübingen Regional Court between existing and new contracts means that banks have to assume that their existing business relationships with private customers in deposit transactions to not cover the option to forward negative interest to the customer. Whether this view will prevail remains to be seen.

The Regional Court does not comment on the issue of whether negative interest can be introduced for new contracts. This is probably the case. Existing contracts which were not concluded in the current economic environment are to be construed in line with the view represented by Tübingen Regional Court to the effect that negative interest is not covered by the respective declarations of intent. But this can be the case for new contracts with correspondingly clear contractual agreements – also with respect to general business terms and conditions.

The need for any notice of termination pending a change of contract therefore depends in each individual case on the wording in the existing contracts and the general business terms and conditions. A simply structured floating interest clause which does not explicitly name the negative interest option is probably not enough in order to introduce negative interest for such an already existing contractual relationship.

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Jurisdiction

New developments on the taxation of recapitalisation gains

Germany has introduced a new legislation dealing with the tax exemption of recapitalisation gains. However, it is not yet applicable and the question is how taxpayers shall behave in these times of uncertainty.

In accordance with the case law of the Federal Tax Court (Bundesfinanzhof), waiving a claim against a company generally results in taxable income for that company, even if the claim has been waived with a view of restructuring the company. The financially distressed company is thus additionally encumbered with a tax debt which may finally render the company insolvent unless there are sufficient loss carry-forwards. This may only be different in case a shareholder of a corporate entity waives its claim against the company, at least to the extent that the claim is recoverable as this constitutes a hidden contribution which must not increase the income. The hidden contribution is to be assessed at current value.

After a statutory regulation to exempt recapitalisation gains from tax was suspended in 1997, the Federal Ministry of Finance (Bundesfinanzministerium) published its recapitalisation order in 2003. This provided for a remission on grounds of equity under certain conditions. In its ruling of 28 November 2016 the Grand Senate of the Federal Tax Court declared the recapitalisation order unlawful as it was up to the legislator alone to order a general waiver of tax claims. The tax authorities then held that the tax payer could still rely on the old order if the claim was waived prior to 08 February 2017 (the date of the court ruling). However, the Federal Tax Court again rejected this ruling of as there was no legal basis for it. The Federal Ministry of Finance now declared that this judgement does not apply to open cases by a non-applicability order dated 29 March 2018.

In the meantime, the legislator also reacted to the repeal of the recapitalisation order and among other things added section 3a to the Income Tax Act. Under this section business gains are in principle tax-exempt if they are the result of a waiver for the purpose of a company-related recapitalisation. Business expenditures which have a direct economic link with tax-free recapitalisation income may not be deducted but will reduce the recapitalisation gains. With the introduction of the new section 7b Trade Tax Act it is confirmed that recapitalisation gains are also generally exempt from trade tax.

A Company-related recapitalisation is deemed to exist if the taxpayer can evidence for the period of the remission the need and suitability of the company for recapitalisation, the suitability of the business-related remission for recapitalisation and the intention of the creditors to recapitalise. In so doing the law is based in fact on the requirements of the previous recapitalisation order.

The wording itself makes it clear that there must be business grounds for the remission. This may not be the case if a shareholder alone waives its claims as the reason for doing so may often be related to corporate matters and not to business grounds. The contrary is only the case if third-party creditors also waive their debts in part or in full and if thus it becomes clear that business grounds are responsible for the waiver. A further condition for the tax exemption is that the company exercises its optional tax rights in a way that reduces profit in the recapitalisation year and the following year (e.g. by opting for write-downs).

If the conditions for the new provision are satisfied the recapitalisation income is first reduced by the non-deductible recapitalisation costs. In order to avoid double benefits the remaining recapitalisation gains are then reduced by netting them with the existing loss positions of the company and, where appropriate, related persons. Any remaining recapitalisation gains are tax-free.

Although this new legislation may be very helpful for the taxpayer, at the moment it is not applicable yet. As the provisions may not be compliant with European state aid they are still subject to an approval of the European Commission. However, as can be heard from people in the Federal Ministry of Finance negotiations are not running smoothly so that it is not possible to say whether the approval will be issued by the European Commission.

Consequences for practitioners:

What does this now mean for the taxpayer? The new legislation does not apply to recapitalisation gains from a remission before 8 February 2017. However, on the basis of the non-applicability order from the Federal Ministry of Finance the taxpayer can hope that the old recapitalisation order will still apply. In case the debt is waived after 8 February 2017, the outcome mainly depends on the reaction of the EU Commission. If it approves the provisions recapitalisation gains will be tax free, subject to the conditions of the new legislation. On the other hand, if the EU Commission decides that the new provisions are not compliant with European state aid rules, then the recapitalisation gains will probably be taxed. The only legal remedy available in this case is an application of the taxpayer to a divergent tax assessment for reasons of equity pursuant to section 163 German Tax Code or the remission of the tax claim by the taxing authority pursuant to section 227 German Tax Code. However, in this case it must be reviewed on the basis of an individual assessment whether there are personal or objective reasons for such equitable measure. Recourse to the general conditions of the previous recapitalisation order would not be permitted.

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