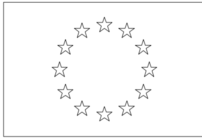

EUROPEAN COMMISSION

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PUBLIC VERSION

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Subject: State aid C7/2010 (ex NN5/2010) – Scheme on the fiscal carry-forward of losses ("Sanierungsklausel")

Sir,

The Commission wishes to inform Germany that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 108(2) TFEU.[1]

1. PROCEDURE

(1) The Commission opened an *ex-officio* case on the tax measure in question in July 2009, when it became aware of the measure through press articles. In the following, the Commission sent an information request to the German authorities on 5 August 2009, to which they replied on 20 August 2009. The German authorities were asked another set of questions on 30 September 2009, to which they submitted additional information on 5 November 2009.

[1] With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the TFEU. The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the Treaty on the Functioning of the European Union (TFEU) should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.

Seiner Exzellenz Herrn Guido WESTERWELLE
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2. DESCRIPTION OF THE MEASURE

(2) The tax measure in question is called "*Sanierungsklausel*", i.e. reorganisation clause, and is applicable to companies in which changes in the shareholding took place earlier. The *Sanierungsklausel* enables such companies, if they are ailing, to carry forward fiscal losses, which would otherwise have been forfeited.

2.1. Introduction

(3) The German corporate income tax act ("*Körperschaftsteuergesetz*") in principle foresees the possibility to carry forward losses incurred in a tax year at the level of a corporate company, meaning that, according to the ability to pay principle, taxable income in future tax years may be reduced by setting-off the losses. This results in a reduction of a future tax burden of the respective corporate company ("*Körperschaft*").

2.2. Fiscal loss carry forward in companies subject to changes in the shareholding

(4) The carry-forward of losses already had been restricted in the 1997 to limit the trafficking of loss carry-forwards in empty shell companies. Such companies have ceased their activities, but are sold as their loss carry-forwards represent a real value: a purchaser of such a shell company with a loss carry–forward benefits from a setting-off of future taxable profits and thus will make a tax saving.

(5) As these restrictions were considered to be unsatisfactory and also in order to counterfinance other tax reductions, the Act to reform company taxation "*Unternehmensteuerreformgesetz 2008*" – provided that for all changes in the direct or indirect shareholding of a company the carry forward of losses is limited. According to § 8c(1) *Körperschaftsteuergesetz*, the possibility to carry forward losses is limited in case of changes in the shareholding of a corporate company ("*Körperschaft*").

- Unused losses are forfeited in total if more than 50% of the share capital, membership rights, ownership rights or voting rights are transferred to an acquirer;

- if within a period of five years more than 25% and up to 50% of the share capital (among others) is transferred, unused losses are forfeited pro rata.

(6) At that time, no specific rule for ailing companies was included, but the legislator already expressed its intention to introduce specific provisions for those companies. [2]

2.3. Introduction of Reorganisation clause ("Sanierungsklausel")

(7) A provision concerning ailing companies, the so-called *Sanierungsklausel,* was introduced in July 2009 with the *Bürgerentlastungsgesetz Krankenversicherung*.[3] The

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[2] According to the explanatory memorandum, i.e. the reasoning given by the legislator, reorganisation of ailing companies should not fall under the limitation but should be dealt with separately by means of administrative proceedings ("im Verwaltungsweg"), cp. BT-Drs. 16/4841, p. 35.

[3] Gesetz zur verbesserten steuerlichen Berücksichtigung von Vorsorgeaufwendungen (Bürgerentlastungsgesetz Krankenversicherung) vom 16. Juli 2009, BGBl. I Nr. 43 p. 1959.

Sanierungsklausel eases the above described limitation of fiscal loss carry forward in case of changes in the shareholding in an ailing company that could be subject to reorganisation.

2.3.1. Objective of the measure

(8) According to the explanatory memorandum, i.e. the reasoning given by the legislator, the *Sanierungsklausel* was introduced to tackle the global financial and economic crisis.[4] The German authorities argue that an additional objective of the *Sanierungsklausel* is to prevent the abuse of the fiscal system. Without such provision, the losses could be trafficked in empty shell companies.

2.3.2. Scope of Reorganisation clause

(9) Under the *Sanierungsklausel*, a corporate company is allowed to carry forward losses despite changes in its shareholding if the following requirements are met:

- the acquisition serves the purpose of reorganising, i.e. turning around ("*Sanierung*") of the corporate company;
- the company is or is to be illiquid or over indebted at the time of acquisition ("*drohende oder eingetretene Zahlungsunfähigkeit oder Überschuldung*");
- the essential business structures of the company are preserved by way of
  - works council agreement ("*Betriebsvereinbarung*") on the preservation of jobs; or
  - preservation of 80% of the jobs for five years following the acquisition; or
  - injections of significant business assets ("*wesentliches Betriebsvermögen*") within twelve months; business assets are material if they amount to at least 25% of the assets of the previous business year;
- the company does not change sector for five years following the acquisition;
- if the company ceased operation at the time of the acquisition, it is not eligible for reorganisation under the *Sanierungsklausel*.

(10) The *Sanierungsklausel* was adopted in July 2009 and is applicable retroactively since 1 January 2008. Originally, the provision should expire on 31 December 2009. However, in the end of 2009, the German government adopted a law rendering the measure permanent (Act on the Acceleration of growth of 22 December 2009, *Wachstumsbeschleunigungs-gesetz*[5]).

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[4] Cp. BT-Drs. 16/13429, p. 50 and BT-Drs. 16/12674 p. 10.

[5] Gesetz zur Beschleunigung des Wirtschaftswachstums (Wachstumsbeschleunigungsgesetz) vom 22. Dezember 2009 (BGBl. I Nr. 81 S. 3950), Article 2(3)(b).

2.4. Beneficiaries of the measure

(11) The beneficiary of the *Sanierungsklausel* is the company to be acquired (target company), which can set-off losses incurred in previous tax years against profits in future tax years. Hence, in these years, the tax burden of the company is reduced**.** It could however, also benefit the acquiring company in cases where the tax law allows for fiscal consolidation of the group.

2.5. Budget

(12) Germany estimates that due to the implementation of the measure tax revenues might decrease by EUR 900 million per year.

3. ASSESSMENT

3.1. Existence of aid

(13) Article 107(1) TFEU lays down that any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods and affects trade among Member States is incompatible with the Internal Market.

3.1.1. State resources

(14) A measure has to be financed through State resources. A loss of tax revenue is equivalent to consumption of State resources in the form of fiscal expenditure. By allowing companies to reduce their corporation tax burden through the carry-forward of losses, the German authorities are foregoing revenue that constitutes State resources. Indeed, the German authorities informed the Commission that tax revenues might decrease by EUR 900 million per year due to the implementation of the measure. Hence, the measure implies a loss of State resources and is thus granted through State resources.

3.1.2. Advantage

(15) The measure must confer an advantage. According to case law, the concept of aid embraces not only positive benefits, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking.[6]

(16) Under the general rule applicable to companies subject to changes in the shareholding, fiscal loss carry forward is limited, i.e. all or part of the losses simply disappear. With the *Sanierungsklausel*, if the change in shareholding concerns an over-indebted or illiquid company, such a company benefits, as it is able to set off losses and thus pays fewer taxes than other companies subject to changes in the shareholding. In this context, it also has to be taken into account that tax saving is essentially only available if an acquiring company invests in a target company fulfilling the criteria of the *Sanierungsklausel*, meaning that

[6] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, paragraph 38.

the provision in question provides an incentive for investors to invest in ailing companies eligible for the *Sanierungsklausel* rather than in other companies.

(17) In case of fiscal consolidation within the group to which the acquired company belongs, it might also be another group company that benefits from the measure. That means that the acquiring company could benefit as well, depending on the amount of shares taken over.

3.1.3. Selectivity

(18) According to the case law of the ECJ, as regards the selectivity of a tax measure, Article 107(1) TFEU requires the assessment of whether under a particular legal regime, a national measure is such as to favour "certain undertakings or the production of certain goods" in comparison with others which, in the light of the objective pursued by that regime, are in a comparable factual and legal situation.[7] Hence, the Commission has to assess the material selectivity of a tax measure in three stages.[8]

(19) Following this, firstly, the common or "normal" regime under the tax system applicable has to be identified ("**system of reference**"). Secondly, it will be assessed and determined whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure **derogates from the system of reference** inasmuch as the measure differentiates between economic operators who, in the light of the objective pursued by that regime, are in a comparable factual and legal situation.

(20) If such derogations exist, meaning that the measure in question *prima facie* appears to be selective, in a third stage, it will be examined whether the differentiation results from the **nature or general scheme of the tax system** of which it forms part and could hence be justified. In this context, according to case law and paragraph 23 of the Commission Notice on the application of the State aid rules to measures relating to direct business taxation[9] (hereinafter referred to as "**Notice on Direct Business Taxation**"), the Member State has to show whether the differentiations derive directly from the basic or guiding principles of that system.

a) System of reference

(21) The system of reference is the German corporate income tax system as it stands, and in particular the rules on fiscal loss carry forward for companies subject to changes in their shareholding. As described above (cp. point 2.2), since the introduction of the *Unternehmensteuerreformgesetz 2008*, unused losses are forfeited in total if more than 50% of the share capital (among others) are transferred to an acquirer; they are forfeited pro rata, if within a period of five years more than 25% and up to 50% of the share capital (among others) is transferred.

[7] Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, paragraph 41; Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, paragraph 68; C-172/03 *Heiser* [2005] ECR I-1627, paragraph 40.
[8] Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C384, 10.12.1998, p. 3.
[9] Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C384, 10.12.1998, p. 3.

(22) The German rules on fiscal loss carry forward for companies subject to changes in their shareholding, as laid down in the *Unternehmensteuerreformgesetz 2008*, were already taken as system of reference in another case, in which it was undisputed that the tax measure was selective. In that case, the described rules on fiscal carry forward of losses were relaxed for companies acquired by venture capital companies, meaning the company itself as well as the venture capital company could benefit from the loss carry forward, which would have lapsed under the basic rule.[10]

(23) Indeed, the rules introduced by the *Unternehmensteuerreformgesetz 2008* are not sector specific and every company subject to a change in its shareholding is subject to the limitation of fiscal loss carry-forward.

(24) Hence the Commission considers the corporate tax rules on fiscal loss carry forward for companies subject to changes in their shareholding as system of reference.

b) Derogation from the system of reference

(25) The tax measure at issue is the *Sanierungsklausel,* which lays down that companies that are or are to be illiquid or over-indebted at the time of their acquisition and need reorganisation can carry-forward their losses. It has to be noted that also companies that are not (potentially) illiquid or over-indebted at the time of acquisition can be loss making. Hence, it seems that they are in a comparable legal and factual situation. However, such "healthy" companies are not eligible for the carry-forward of losses. It appears that the *Sanierungsklausel* differentiates between healthy companies that are loss making and companies that are (potentially) illiquid or over-indebted, in benefitting the latter. The *Sanierungsklausel* thus seems to derogate from the system of reference, according to which both types of companies would not be eligible for loss-carry forward. It *prima facie* seems to be selective.

(26) The German authorities argue that according to the Commission Notice on Direct Business Taxation some conditions may be justified by objective differences between taxpayers. A company within the meaning of the *Sanierungsklausel* has to be reorganised. It is thus in a specific situation, as it does not get capital on the markets. Indeed, the survival of the company depends on the investments from an acquiring company.

(27) At this stage, the Commission doubts such a distinction can be made. As outlined above, also companies subject to changes in shareholdings that are not in need of reorganisation can be loss making. The Commission does not see an objective difference between such potential tax payers.

(28) In addition, the German authorities state themselves that the measure is not general, as it only applies to companies that are in a specific situation, namely ailing companies. Indeed, as already mentioned above, in a comparable situation concerning the relaxation

[10] Case C 2/2009 *MoRaKG, Conditions for Capital Investment* (OJ L 6 9.1.2010, p. 32).

of fiscal carry forward of losses for companies acquired by venture capital companies, it was undisputed that such a measure was selective.[11]

(29) Hence, at this stage the Commission considers that the *Sanierungsklausel prima facie* constitutes a selective measure.

c) Justification

(30) A measure can be justified by the nature and general scheme of the tax system if it derives directly from the basic principles of the tax system. As outlined above (paragraph 22), it is for the Member State, i.e. for the German authorities, to provide such justification.

(31) The German authorities argue that the *Sanierungsklausel* is justified, as one of its objectives is to prevent the abuse of the tax system by way of trafficking losses through empty shell companies. This goal is inherent to the German tax system. The *Sanierungsklausel* differentiates coherently within this system and does not allow the purchase of empty shell companies for purely fiscal reasons either.

(32) At this stage, the Commission has doubts that the measure could be justified by way of this reasoning. According to the explanatory memorandum, the *Sanierungsklausel* was introduced to tackle the global financial and economic crisis The German authorities admit themselves that in the financial crisis, the limitation of loss carry forward would create particular obstacles to the restructuring of companies. Indeed, it has to be taken into account that the limitation of loss carry-forwards introduced in 2008 (but also providing a *Sanierungsklausel*) was explicitly made for the financing of the reduction of the corporate income tax rate from 25 to 15 %.[12] Hence, the sole objective of the *Sanierungsklausel* seems indeed not to be the prevention of the abuse of the tax system.

(33) In addition, the German authorities state that also other Member States provide tax benefits for the restructuring of companies, such as the French aid scheme for the takeover of firms in difficulty.

(34) At this stage, the Commission cannot follow this argument. Firstly, the Member States can, in order to justify a measure, only refer to the principles inherent to their tax system, as the point of reference by which to assess whether an undertaking receives an advantage in the sense of the State aid rules is the generally applicable system in the Member State concerned; the question which rules apply in other Member States is, in principle, irrelevant.[13] Secondly, the conditions of measures in the other Member States seem to differ from the *Sanierungsklausel*. The French scheme, for example, foresees a tax exemption for newly created companies who take over a firm in difficulty. After the scheme was declared incompatible by the Commission in 2003[14], France changed it to

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[11] Case C 2/2009 *MoRaKG, Conditions for Capital Investment* (OJ L 6 9.1.2010, p. 32).
[12] Cp. BT-Drs. 16/4841.
[13] Cp. Case C 2/2009 *MoRaKG, Conditions for Capital Investment* (OJ C 60, 14.3.2009, p. 9), paragraph 25; Case C 2/2009 *MoRaKG, Conditions for Capital Investment* (OJ L 6, 9.1.2010, p. 32), paragraph 32.
[14] Cp. Case C57/2002 *Tax exemption for takeover of firms in difficulty* (OJ L 108, 16.4.2004, p. 38).

comply with the State aid rules. The benefits provided are now partly de-minimis. The other part of the aid is compatible as regional aid or SME aid[15].

(35) Hence, the Commission has doubts that the measure in question derives directly from the basic principles of the tax system and that it is justified by the nature and general scheme of the tax system.

3.1.4. Effect on intra-community trade

(36) According to Article 107(1) TFEU, the measure must affect intra-Community trade and distort, or threaten to distort competition. The *Sanierungsklausel* is not sector specific, i.e. that all sectors could benefit from it. At least some of the sectors benefitting, such as the automotive industry, are surely exposed to strong competition and intra-community trade. Hence, the measure affects intra-Community trade and distorts or threatens to distort competition.

3.1.5. Conclusion

(37) As all the requirements laid down in Article 107(1) TFEU seem to be met, the Commission at this stage considers the *Sanierungsklausel* to entail State aid.

3.2. Compatibility

(38) State aid measures can be considered compatible on the basis of the exceptions laid down in Article 107(2) and 107(3) TFEU.

(39) So far, the Commission preliminarily assessed the compatibility of the measure under Article 107(3)(b) TFEU and the Communication on State aid for rescuing and restructuring firms in difficulty[16] (hereinafter referred to as "**Rescue and Restructuring Guidelines**"). In addition, it was considered whether the measure could be compatible as regional aid. As regards compatibility on any other basis, so far, the Commission had no indications.

3.2.1. Article 107(3)b TFEU

(40) As the *Sanierungsklausel* was introduced in order to tackle the problems resulting from the financial and economic crisis, the Commission preliminarily assessed whether it could be declared compatible under Article 107(3)b TFEU. According to this Article, the Commission may declare compatible aid "to remedy a serious disturbance in the economy of a Member State".

(41) In the light of the current financial crisis and economic crisis and their impact on the overall economy of the Member States, the Commission considers that certain categories of State aid are justified, for a limited period, to remedy this crisis and they can be declared compatible with the internal market under Article 107(3)(b) of the TFEU. The

[15] Cp. Case N 553/2004 *Tax exemption for takeover of firms in difficulty* (OJ C 242, 1.10.2005, p. 5).

[16] Communication from the Commission- Community Guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C244, 1.10.2004, p. 2.

most appropriate measures in this context have been presented in the Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis[17] (hereinafter referred to as "Temporary Framework").

(42) However, the *Sanierungsklausel* seems not to fall under any of these measures outlined in the Temporary Framework, as it concerns fiscal advantages to companies in difficulty. Hence, so far, it seems that the tax advantage in form of the *Sanierungsklausel* could not comply with the Temporary Framework.

(43) Therefore, the Commission has doubts that the *Sanierungsklausel* could meet the requirements for being declared compatible under Article 107(3)b of the TFEU.

3.2.2. Rescue and Restructuring aid

(44) As the *Sanierungsklausel* concerns tax advantages to ailing companies, the Commission preliminarily examined its compatibility under the Rescue and Restructuring Guidelines. Under these Guidelines, only companies in difficulty are eligible. Whereas it seems that an illiquid or over-indebted company might be considered as being in difficulty within the meaning of the Guidelines, it has to be taken into account that a firm belonging to or being taken over by a larger business group is normally not eligible for rescue or restructuring aid (paragraph 13 of the Rescue and Restructuring Guidelines). One of the requirements of the *Sanierungsklausel* is a change in the shareholding. After such a change, the target company might belong to a group. In this case, it would normally be for the group to take care of the target company in difficulty which would then not be eligible under the Rescue and Restructuring Guidelines.

(45) In addition, even for beneficiaries eligible for aid under the Rescue and Restructuring Guidelines, the other requirements of these Guidelines would possibly not be met:

(46) According to paragraph 25(a) of the Rescue and Restructuring Guidelines, rescue aid can only take the form of loans or guarantees. Hence, the tax advantage in question cannot be considered as rescue aid.

(47) In case of restructuring aid, the Rescue and Restructuring Guidelines (paragraph 31 et seq.) require the submission of a sound restructuring programme that allows for restoring the viability of the company. The aid must be limited to the minimum necessary. In this context, the beneficiary has to make an own contribution to the costs of restructuring. Finally, to avoid undue distortions of competition, the Rescue and Restructuring Guidelines foresee compensatory measures.

(48) At this stage, these conditions appear not to be met by the *Sanierungsklausel*. While the explanatory memorandum foresees that the target company has to provide a reorganisation plan with a positive continuation prognosis, there is no indication that such

[17] Communication from the Commission – Temporary Community Framework for State aid measures to support access to finance in the current financial and economic crisis, OJ C 83, 7.4.2009, p. 1.

a plan would fulfil the requirements of the Guidelines. There is no indication that the amount of the aid will be limited to the minimum necessary. Indeed, the amount of the aid will depend on the losses that a company incurred in the past. It does not seem that the *Sanierungsklausel* foresees an own contribution or compensatory measures.

(49) Finally, rescue and restructuring aid to large enterprises have to be individually notified. They cannot be subject to a scheme. The *Sanierungsklausel* does not distinguish between large companies and SMEs.

(50) Overall, the Commission has doubts that the measures could be compatible as restructuring aid.

3.2.3. Regional aid

(51) At this stage, the Commission considers that some of the beneficiaries could be considered healthy companies, as in case that fiscal consolidation within the group to which the target company belongs takes place, the parent company or the acquiring company respectively could benefit from the *Sanierungsklausel*. Such a company is not necessarily in difficulty and could hence be eligible for regional aid. However, as the sole acquisition of the shares of the legal entity of an enterprise does not qualify as initial investment under the Regional Aid Guidelines[18], it seems that tax advantages granted for the investment of the acquiring company would not fall under the Regional Aid Guidelines. Furthermore, the potential beneficiaries have to be located in a German region eligible for regional aid. Under the *Sanierungsklausel*, this is not necessarily the case, as the provision applies to companies located in all parts of Germany. In addition, it is questionable that the other requirements of the Regional Aid Guidelines would be met.

(52) Hence, *prima facie*, the Commission doubts that the measure could be considered compatible as regional aid.

4. CONCLUSION

(53) In the light of the above considerations, the Commission has decided to initiate the formal investigation procedure provided for in Article 108(2) TFEU to the measure in question.

Decision

In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 108(2) TFEU, requests Germany to submit its comments and to provide all such information as may help to assess the aid, within one month of the date of receipt of this letter.

It requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

[18] Guidelines on national regional aid from 2007 to 2013, OJ C 54, 4.3.2006, p. 13.

The Commission wishes to remind Germany that Article 108(3) TFEU has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns Germany that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the *Official Journal of the European Union* and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President of the Commission