

Client Briefing

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Federal Fiscal Court (I R 37/22) clarifies the requirements for the proper performance of tax consolidating groups

The Supreme Tax Court (BFH) has ruled on the long-standing controversial issue of the timeframe within which claims arising from profit and loss transfer agreements (PLTA) must be settled in order not to jeopardise the tax recognition of tax consolidating groups.

The provisions governing German tax consolidating groups (so-called "*Organschaft*") under Corporate Income Tax and Trade Tax law are characterised, on the one hand, by a high degree of complexity and, on the other, by an importance that cannot be underestimated, as they form the basis for consolidated group taxation under German tax law. The regulations permit the transfer of profits between group companies without triggering dividend taxation, as well as the cross-company offsetting of losses. Due to the exceptional nature of the *Organschaft* regulations, legislator and case law impose high requirements for the recognition of tax consolidating groups, which have been further expanded following a recent decision by the BFH.

I. The Performance of PLTAs

In addition to other requirements for an *Organschaft* under income tax law, which are not shown in detail here, the tax recognition of an *Organschaft* depends on a PLTA being concluded for a minimum term of five years and being performed throughout its entire term of validity (Section 14 (1) sentence 1 no. 3 of the German Corporate Income Tax Act (KStG)). In addition to the proper conclusion of a PLTA and the minimum five-year contract term, this already requires, in particular according to existing case law, that the

profit or loss of the controlled company (*Organgesellschaft*) is properly determined in accordance with the provisions of the German Commercial Code (HGB) and that the resulting claim for profit transfer or loss compensation is recorded accordingly in the annual financial statements (see BFH judgment I R 37/19 of 2 November 2022, BStBl. II 2023, 409). This claim must also be properly fulfilled (see below V.).

It has long been disputed whether, for the "performance" of the PLTA, fulfilment must take place

“promptly” and, if so, which timeframe applies. In this respect, the BFH now provides clarity, but at the same time increases the requirements for the proper performance of PLTAs.

II. The BFH’s Decision

The judgment was based on the following facts: In 2002, a GmbH (subsidiary) concluded a PLTA with the business of its sole shareholder, an individual (parent company). Under Section 3 of the PLTA, the respective payment obligations under the agreement became due upon the adoption of the annual financial statements. The profits to be transferred to the parent company were merely recorded in a clearing account (*Verrechnungskonto*) over the years but were not balanced. Actual fulfilment for the disputed years 2009 to 2011 took place in 2014 at the earliest, or even as late as 2017.

The tax office therefore denied the existence of a tax consolidating group – and the Cologne Fiscal Court confirmed this at first instance. The PLTA had not actually been performed, as the subsidiary had not fulfilled its obligation to transfer the profits within a reasonable time after they became due.

The BFH dismissed the subsidiary’s appeal against this decision and concurred with the tax office and the Cologne Fiscal Court. It confirmed previous BFH case law, according to which the receivables and liabilities arising from the PLTA must also be recorded in the annual financial statements. Furthermore, the actual performance of the PLTA requires the timely fulfilment of profit transfer claims. In principle, fulfilment within **twelve months of the due date of the profit transfer obligation** (or the loss compensation obligation) is sufficient for the proper performance of a PLTA.

III. On the due Date of the Claim under a PLTA

However, in this judgment, the BFH does not expressly comment on when the claim under a PLTA becomes due but refers to the civil law principles governing the due date of profit transfer or loss compensation claims. Insofar as the due date (within the limits of what is permissible) has not been

agreed between the parties to the PLTA, a distinction must be made between a profit transfer claim and a loss compensation claim.

According to the prevailing view, the claim for loss compensation becomes due upon the expiry of the financial year (balance sheet date), see Federal Court of Justice (BGH), judgment of 11 October 1999, II ZR 120/98, NJW 2000, 210. According to case law, this is justified by the purpose of the claim for loss compensation under section 302 of the German Stock Corporation Act (AktG), which aims to protect the minority shareholders and the creditors of the controlled company.

The date on which the claim for the transfer of profits becomes due, however, is a matter of dispute. According to the prevailing view, the claim for the transfer of profits becomes due when the shareholders approve the balance sheet. This is partly derived from an interpretation of the PLTA in accordance with section 271 (1) of the German Civil Code (BGB). Similarly, the BFH had ruled in an early decision in 1964 (Ref.: II 246/60 U, BStBl III 1964, 334) that the claim only becomes due at the time the balance sheet is approved. According to another view, the claim becomes due as soon as the financial year ends.

The BFH left open the question of whether and to what extent, for reasons of proportionality, minor irregularities in the performance of the contract may be deemed harmless. Nor did it comment on the question of the conditions under which a PLTA is performed if, due to special circumstances, there are delays in the adoption of the balance sheet.

The aforementioned principles must be observed in the practical application of group relationships. Furthermore, the legal uncertainties regarding the determination of the due date for the purposes of the profit transfer claim suggest that both the loss compensation and profit transfer claims should be duly fulfilled within twelve months of the balance sheet date.

In view of this clear twelve month time limit rule, expressed for the first time by the BFH, proactive management and monitoring of the

fulfilment of profit transfer and loss offset obligations is recommended.

IV. Special Circumstances in the Post-Contractual Area

The BFH has not expressly taken a position on the practically relevant question of the fulfilment of the PLTA in the final year of its validity. In this case, the fulfilment of the relevant claim can inevitably only take place after the end of the contract term.

The BFH's reasoning suggests that the fulfilment of individual liabilities arising from the PLTA remains possible even after the agreement has terminated. The BFH bases its reasoning on the fact that, were the *"timeframe for fulfilment extended"*, the taxpayer could dissolve the *Organschaft* with unlimited retro-active effect, rather than merely within the five-year period provided for by law. However, such an *"unlimited right of choice"* only arises if the fulfilment of the PLTA is shifted to the period following its termination, either in its entirety or for several years, but not merely for the final year of the PLTA's validity.

In this respect, too, however, further developments must be monitored following the BFH's decision.

V. Proper Claim Fulfilment

The BFH commented only very briefly on the proper fulfilment of the claims under the PLTA. For example, fulfilment by payment of the profit transfer obligation is frequently avoided in practice, as the affiliated company requires the liquidity; however, from a tax perspective, this represents the safest route.

In the case in question, the profit transfer claim was booked on a clearing account. This did not constitute fulfilment sufficient to satisfy the preconditions of tax law. In this context, the proper "set-off" of claims under a PLTA against counterclaims must be understood to mean that the set-off must be equivalent to an actual payment; merely recording the claim without any compensation effect is, however, insufficient.

Thus, although booking on a clearing account may in principle be suitable for proper fulfilment of claims,

this applies only if counterclaims or lump-sum payments are also booked on the clearance account and a regular account reconciliation takes place, as provided for in Section 355 HGB for current accounts, which would be a prerequisite under civil law for the extinction of the claims and liabilities recorded on such account. In the absence of this, the BFH considers that a so-called "non-genuine clearing account" (*"unechtes Verrechnungskonto"*) exists; an entry in such an account cannot be regarded as a valid act of claim fulfilment.

In the view of the BFH, other forms of fulfilment of claims may arise if, for example, the claim for the profit transfer is converted, through the closing of accounts, into an abstract acknowledgement of debt or into a loan (at arm's length terms and entered into in good faith), so that, due to the novation of the legal basis, fulfilment is affected in lieu of fulfilment (*an Erfüllungs statt*).

Particular attention should be paid to profit transfer and loss compensation obligations within a cash pool or cash clearing system.

VI. Outlook

The reform of the German group tax regulations towards genuine group taxation – as has been practised in Austria for around 20 years, for example – which has long been called for on various occasions, remains out of sight. Consequently, domestic corporate groups will have to grapple with the high degree of complexity of the PLTA and group tax system – which is scarcely known internationally – for the foreseeable future. The interplay of company law and tax requirements for an effective *Organschaft* necessitates scrutiny and monitoring of the tax consolidating group during its implementation, performance and, where applicable, subsequent termination.

The BFH's decision once again highlights the great importance of the actual performance of the PLTA during its period of validity. Any issues of doubt, including those relating to the frequently contentious question of the effective fulfilment of claims under a PLTA, should therefore be examined at an early stage, and appropriate internal processes to ensure compliance with the requirements for an effective

tax consolidating group should be established or reviewed for their effectiveness.

This client information provides only a non-binding overview of the subject matter addressed herein. It does not constitute legal advice. We are happy to assist you regarding this client information and your advisory matters:



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