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Investing in German Tax Claims

- A brief overview on the legal framework and dealing in practice -

In almost all insolvency proceedings, claw-back claims are also directed against tax authorities. Although the proceedings for the enforcement of tax claims before the tax authorities and tax courts usually take a very long time, these claims are nevertheless often enforced, especially as the recoverability of the claims - as they are directed against the state - is guaranteed.

Tax claims are often not only transferred to trustees so as not to hinder the implementation of the insolvency proceedings - in particular insolvency plan proceedings - due to the long duration of tax litigations. In addition, the tax litigation is often pre-financed by litigation financiers - especially in the case of high, disputed tax claims. Nonetheless, the investment in such tax claims is not only interesting for traditional litigation financiers, but also for financial investors in general.

The following is a brief overview of the legal framework for the investment in tax claims against German tax authorities, and the dealing with such investment in practice.

Firstly, it should be noted that tax receivables may not be assigned as part of a „business-like activity“ (also not by way of security), whereby a „business-like activity“ is deemed to exist if the assignment of receivables is carried out "independently and with the intention of repeating it". This means that the assignment of receivables may only be carried out "on a commercial basis" to companies that have a licence to conduct banking business (in Germany in accordance with Section 32 of the German Banking Act). Foreign companies must have a corresponding licence under their respective national law. A further prerequisite for the effective assignment of tax receivables, which is only mentioned here for the sake of completeness, is the use of the forms provided by the German tax authorities for assignments of tax claims.

However, the above restriction in relation to the assignment or assignment by way of security of tax receivables is rather of minor relevance in practice. This is because tax claims are typically not financed through direct sale or assignment by way of security, but by (i) initially financing the tax proceedings accordingly and then, after successful completion, (ii) on the basis of an agreement between the tax debtor and the financier on the financier's participation in the proceedings, and usually through a percentage share in the refund of the tax claimed in the tax proceedings. A typical constellation in the context of self-administration proceedings and the restructuring through an insolvency plan is that the tax claim is assigned to a trustee as part of the insolvency plan, who then conducts the tax litigation with the corresponding authorisations in the trust agreement. The trust agreement on which the trust is based then usually provides for the proceeds from the tax proceedings, less a fee for the trustee and the costs of the proceedings, to be paid out to the debtor for further distribution to the creditors - thus increasing the insolvency quota. In an agreement with the trustee and, if applicable, the debtor, the financier normally assumes existing risks in the judicial enforcement of tax claims by initially financing the costs of the proceedings and, if successful, receiving a share of the inflow of tax refunds requested in the tax litigation.

The details of such an agreement naturally depend on the individual case, and the preparation of such an investment in tax claims certainly requires a certain amount of time and expense. Above all, the interested investor will have the prospects of success of the tax litigation assessed in advance by an independent expert. Nevertheless - as already mentioned at the beginning - it should not be forgotten that in the event of success, there is a claim against the relevant tax office with full value, the fulfilment of which usually takes place within a short time after a legally binding decision. Although investing in tax claims therefore requires a certain amount of preparatory work, it can certainly be economically interesting for financial investors.

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